

Edgar Filing: APPLIED DNA SCIENCES INC - Form 10QSB/A

APPLIED DNA SCIENCES INC  
Form 10QSB/A  
May 23, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-QSB/A  
Amendment No. 1

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

TRANSITION REPORT PURSUANT TO SECTION 13 OR  
15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly period ended March 31, 2006

Commission file number 002-90519

APPLIED DNA SCIENCES, INC.  
(Exact name of registrant as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

59-2262718  
(I.R.S. Employer  
Identification Number)

25 Health Sciences Drive, Suite 113  
Stony Brook, New York  
(Address of Principal Executive Offices)

11790  
(Zip Code)

(631) 444-6861  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the last 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares of Common Stock, \$0.001 par value, outstanding on March 31, 2006, was 118,582,385 shares, held by approximately 1,380 shareholders.

Transitional Small Business Disclosure Format (check one):

Yes  No

APPLIED DNA SCIENCES, INC  
QUARTERLY REPORT ON FORM 10-QSB FOR THE  
QUARTERLY PERIOD ENDING MARCH 31, 2006

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## PART I. FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

APPLIED DNA SCIENCES, INC.  
(A DEVELOPMENT STAGE COMPANY)  
CONDENSED CONSOLIDATED BALANCE SHEET  
MARCH 31, 2006  
(Unaudited)

#### ASSETS

Current assets:

Cash and cash equivalents	\$ 77,71
Advances and other receivables	3,12

Total current assets	80,84
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Property, plant and equipment - Net of accumulated depreciation of \$6,265	42,33
Deposits and prepaid expenses	23,38
Intangible assets:	
Patents, net of accumulated amortization of \$15,168 (Note B)	19,08
Intellectual Property , net of accumulated amortization of \$1,010,454 (Note B)	8,420,44
Total	\$ 8,586,09
=====	
Assets	

LIABILITIES AND DEFICIENCY IN STOCKHOLDERS' EQUITY

Current liabilities:	
Accounts payable and accrued liabilities	\$ 2,274,40
Accrued liabilities due related parties	2,49
Note payable (Note D)	510,42
Total current liabilities	2,787,32
Warrant Liability (Note G)	6,787,39
Convertible Note payable, net of unamortized discount (Note D)	676,79
Commitments and contingencies (Note I)	
Deficiency in Stockholders' Equity:	
Preferred stock, par value \$.001 per share; 10,000,000 shares authorized; 60,000 issued and outstanding	
Common stock, par value \$.001 per share; 250,000,000 shares authorized; 118,582,385 shares issued and outstanding	118,58
Common stock subscription	(200,00
Additional paid-in-capital	88,220,81
Total Accumulated Deficit	(89,804,81
Total Deficiency in Stockholders' Equity	(1,665,41
Total liabilities and Deficiency in Stockholders' equity	\$ 8,586,09
=====	

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC.  
(A DEVELOPMENT STAGE COMPANY)  
CONDENSED CONSOLIDATED STATEMENTS OF LOSSES  
(Unaudited)

	For the Three Months Ended March 31		For the S Months End March 31
	2006	2005	2006
	-----	-----	-----

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(as restated  
see Note I)

Operating expenses:				
Selling, general and administrative	\$ 1,009,934	\$ 10,406,288	\$ 3,088,661	\$
Research and development	75,033	--	91,303	
Depreciation and amortization	341,676	7,306	684,375	
	-----	-----	-----	-----
Total operating expenses	1,426,643	10,413,594	3,864,339	
Operating loss	(1,426,643)	(10,413,594)	(3,864,339)	
Net gain/(loss) on revaluation of warrant liability	4,846,273	13,310,729	12,973,966	
Other income (expense)	(3,520)	3,100	9,493	
Interest income (expense)	(59,597)	(19,567,738)	(79,403)	
Income (taxes) benefit	--	--	--	
	-----	-----	-----	-----
Net Income (Loss)	\$ 3,356,513	\$ (16,667,503)	\$ 9,039,717	\$
Earnings (Loss) per common share:				
Basic	\$ .03	\$ (0.31)	\$ .08	\$
Diluted				
Weighted average shares outstanding:	\$ .03	\$ (0.31)	\$ .08	\$
Basic	116,483,044	53,044,883	114,487,589	
Diluted	116,533,352	53,044,883	114,550,086	

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
	-----	-----	-----	-----	-----	-----
Issuance of common stock to Founders in exchange for services on September 16, 2002 at \$.01 per share	-	\$ -	100,000	\$ 10	\$ 990	-
Net Loss	-	-	-	-	-	-

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Balance at September 30, 2002	-	-	100,000	10	990	-
Issuance of common stock in connection with merger with Prohealth Medical Technologies, Inc on October 1, 2002	-	-	10,178,352	1,015	-	-
Cancellation of Common stock in connection with merger with Prohealth Medical Technologies, Inc on October 21, 2002	-	-	(100,000)	(10)	(1,000)	-
Issuance of common stock in exchange for services in October 2002 at \$ 0.65 per share	-	-	602,000	60	39,070	-
Issuance of common stock in exchange for subscription in November and December 2002 at \$ 0.065 per share	-	-	876,000	88	56,852	-
Cancellation of common stock in January 2003 previously issued in exchange for consulting services	-	-	(836,000)	(84)	(54,264)	-
Issuance of common stock in exchange for licensing services valued at \$ 0.065 per share in January 2003	-	-	1,500,000	150	97,350	-
Issuance of common stock in exchange for consulting services valued at \$ 0.13 per share in January 2003	-	-	586,250	58	76,155	-
Issuance of common stock in exchange for consulting services at \$ 0.065 per share in February 2003	-	-	9,000	1	584	-
Issuance of common stock to Founders in exchange for services valued at \$0.0001 per share in March 2003	-	-	10,140,000	1,014	-	-
Issuance of common stock in exchange for consulting services valued at \$2.50 per share in March 2003	-	-	91,060	10	230,624	-

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)

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FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Amount	Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
	-----	-----	-----	-----	-----	-----	-----
Issuance of common stock in exchange for consulting services valued at \$ 0.065 per share in March 2003	-	-	6,000		1	389	-
Common stock subscribed in exchange for cash at \$1 per share in March 2003	-	-	-		-	18,000	-
Common stock issued in exchange for consulting services at \$ 0.065 per share on April 1, 2003	-	-	860,000		86	55,814	-
Common stock issued in exchange for cash at \$ 1.00 per share on April 9, 2003	-	-	18,000		2	-	-
Common stock issued in exchange for consulting services at \$ 0.065 per share on April 9, 2003	-	-	9,000		1	584	-
Common stock issued in exchange for consulting services at \$ 2.50 per share on April 23, 2003	-	-	5,000		1	12,499	-
Common stock issued in exchange for consulting services at \$ 2.50 per share, on June 12, 2003	-	-	10,000		1	24,999	-
Common stock issued in exchange for cash at \$ 1.00 per share on June 17, 2003	-	-	50,000		5	49,995	-
Common stock subscribed in exchange for cash at \$ 2.50 per share pursuant to private placement on June 27, 2003	-	-	-		-	-	24,000
Common stock retired in exchange for note payable at \$0.0118 per share, on June 30, 2003	-	-	(7,500,000)		(750)	750	-
Common stock issued in exchange for consulting services at \$0.065 per share, on June 30, 2003	-	-	270,000		27	17,523	-
Common stock subscribed in exchange for cash at							

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\$ 1.00 per share pursuant to private placement on June 30, 2003	-	-	-	-	-	10,000
Common stock subscribed in exchange for cash at \$ 2.50 per share pursuant to private placement on June 30, 2003	-	-	-	-	-	24,000
Common stock issued in exchange for consulting services at approximately \$2.01 per share, July 2003	-	-	213,060	21	428,798	-

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
	-----	-----	-----	-----	-----	-----
Common stock canceled in July 2003, previously issued for services rendered at \$2.50 per share	-	-	(24,000)	(2)	(59,998)	-
Common stock issued in exchange for options exercised at \$1.00 in July 2003	-	-	20,000	2	19,998	-
Common stock issued in exchange for exercised of options previously subscribed at \$1.00 in July 2003	-	-	10,000	1	9,999	(10,000)
Common stock issued in exchange for consulting services at approximately \$2.38 per share, August 2003	-	-	172,500	17	410,915	-
Common stock issued in exchange for options exercised at \$1.00 in August 2003	-	-	29,000	3	28,997	-
Common stock issued in exchange for						

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consulting services at approximately \$2.42 per share, September 2003	-	-	395,260	40	952,957	-
Common stock issued in exchange for cash at \$2.50 per share-subscription payable-September 2003	-	-	19,200	2	47,998	(48,000)
Common stock issued in exchange for cash at \$2.50 per share pursuant to private placement September 2003	-	-	6,400	1	15,999	-
Common stock issued in exchange for options exercised at \$1.00 in September 2003	-	-	95,000	10	94,991	-
Common stock subscription receivable reclassification adjustment	-	-	-	-	-	-
Common Stock subscribed to at \$2.50 per share in September 2003	-	-	-	-	-	300,000
Net Loss for the year ended September 30, 2003	-	-	-	-	-	-
Balance at September 30, 2003	-	\$ -	17,811,082	\$ 1,781	\$2,577,568	\$ 300,000

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
Preferred shares issues in exchange for services at \$25.00 per share, October 2003	15,000	15	-	-	-	-
Common stock issued in exchange for consulting services at approximately \$2.85 per share, October 2003			287,439	29	820,389	-



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Common stock issued in exchange for cash at \$2.50 per share-subscription payable-October 2003	120,000	12	299,988	(300,000)
Common stock canceled in October 2003, previously issued for services rendered at \$2.50 per share	(100,000)	(10)	(249,990)	-
Common stock issued in exchange for consulting services at approximately \$3 per share, November 2003	100,000	10	299,990	-
Common stock subscribed in exchange for cash at \$2.50 per share pursuant to private placement, November, 2003	100,000	10	249,990	-
Common stock subscribed in exchange for cash at \$2.50 per share pursuant to private placement, December, 2003	6,400	1	15,999	-
Common stock issued in exchange for consulting services at approximately \$2.59 per share, December 2003	2,125,500	213	5,504,737	-
Common Stock subscribed to at \$2.50 per share in December 2003	-	-	-	104,000
Beneficial conversion feature relating to notes payable	-	-	1,168,474	-
Beneficial conversion feature relating to warrants	-	-	206,526	-
Adjust common stock par value from \$0.0001 to \$0.50 per share, per amendment of articles dated Dec 2003	-	10,223,166	(10,223,166)	-
Common Stock issued pursuant to subscription at \$2.50 share in Jan 2004	41,600	20,800	83,200	(104,000)
Common stock issued in exchange for consulting services at \$2.95 per share, Jan 2004	13,040	6,520	31,948	-
Common stock issued in exchange for consulting services at \$2.60 per share, Jan 2004	123,000	61,500	258,300	-

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APPLIED DNA SCIENCES, INC  
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
Common stock issued in exchange for consulting services at \$3.05 per share, Jan 2004			1,000	500	2,550	-
Common stock issued in exchange for employee services at \$3.07 per share, Feb 2004			6,283	3,142	16,147	-
Common stock issued in exchange for consulting services at \$3.04 per share, Mar 2004			44,740	22,370	113,640	-
Common Stock issued for options exercised at \$1.00 per share in Mar 2004			55,000	27,500	27,500	-
Common stock issued in exchange for employee services at \$3.00 per share, Mar 2004			5,443	2,722	13,623	-
Common stock issued in exchange for employee services at \$3.15 per share, Mar 2004			5,769	2,885	15,292	-
Preferred shares converted to common shares for consulting services at \$3.00 per share, Mar 2004	(5,000)	(5)	125,000	62,500	312,500	-
Common stock issued in exchange for employee services at \$3.03 per share, Mar 2004			8,806	4,400	22,238	-
Common Stock issued pursuant to subscription at \$2.50 per share in Mar. 2004			22,500	11,250	(9,000)	-
Beneficial Conversion Feature relating to Notes Payable			-	-	122,362	-
Beneficial Conversion Feature relating to Warrants			-	-	177,638	-
Common stock issued in exchange for consulting services at \$2.58 per share, Apr 2004			9,860	4,930	20,511	-

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Common stock issued in exchange for consulting services at \$2.35 per share, Apr 2004			11,712	5,856	21,667	-
Common stock issued in exchange for consulting services at \$1.50 per share, Apr 2004			367,500	183,750	367,500	-
Common stock returned to treasury at \$0.065 per share, Apr 2004			(50,000)	(25,000)	21,750	-
Preferred stock converted to common stock for consulting services at \$1.01 per share in May 2004	(4,000)	(4)	100,000	50,000	51,250	-
Common stock issued per subscription May 2004			10,000	5,000	(4,000)	-

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
Common stock issued in exchange for consulting services at \$0.86 per share in May 2004			137,000	68,500	50,730	-
Common stock issued in exchange for consulting services at \$1.15 per share in May 2004			26,380	13,190	17,147	-
Common stock returned to treasury at \$0.065 per share, Jun 2004			(5,000)	(2,500)	2,175	-
Common stock issued in exchange for consulting services at \$0.67 per share in June 2004			270,500	135,250	45,310	-
Common stock issued in exchange for consulting services at \$0.89 per share in June 2004			8,000	4,000	3,120	-
Common stock issued in exchange for consulting services at \$0.65 per share in June 2004			50,000	25,000	7,250	-

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Common stock issued pursuant to private placement at \$1.00 per share in June 2004			250,000	125,000	125,000	-
Common stock issued in exchange for consulting services at \$0.54 per share in July 2004			100,000	50,000	4,000	-
Common stock issued in exchange for consulting services at \$0.72 per share in July 2004			5,000	2,500	1,100	-
Common stock issued in exchange for consulting services at \$0.47 per share in July 2004			100,000	50,000	(2,749)	-
Common stock issued in exchange for consulting services at \$0.39 per share in August 2004			100,000	50,000	(11,000)	-
Preferred stock converted to common stock for consulting services at \$0.39 per share in August 2004	(2,000)	(2)	50,000	25,000	(5,500)	-
Common stock issued in exchange for consulting services at \$0.50 per share in August 2004			100,000	50,000	250	-
Common stock issued in exchange for consulting services at \$0.56 per share in August 2004			200,000	100,000	12,500	-
Common stock issued in exchange for consulting services at \$0.41 per share in August 2004			92,500	46,250	(8,605)	-
Common stock issued in exchange for consulting services at \$0.52 per share in September 2004			1,000,000	500,000	17,500	-

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
-----	-----	-----	-----	-----	-----

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Common stock issued in exchange for consulting services at \$0.46 per share in September 2004			5,000	2,500	(212)	-
Common stock issued pursuant to subscription at \$0.50 per share in September 2004			40,000	20,000	-	-
Preferred shares converted to common stock for consulting services at \$0.41 per share in September 2004	(4,000)	(4)	100,000	50,000	4,000	-
Preferred shares issued in exchange for service at \$25 per share in September 2004	60,000	6			1,499,994	
Warrants issued to consultants in the fourth quarter 2004					2,019,862	
Net Loss			-	-	-	-
September 30, 2004	60,000	6	23,981,054	11,990,527	6,118,993	-

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
Common stock issued in exchange for consulting services at \$0.68 per share in October 2004	-	-	200,000	100,000	36,000	-
Common stock returned to treasury at \$0.60 per share, Oct 2004	-	-	(1,069,600)	(534,800)	(107,298)	-
Common stock issued in exchange for consulting services at						

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\$0.60 per share in October 2004	-	-	82,500	41,250	8,250	-
Common Stock issued pursuant to subscription at \$0.60 share in October 2004	-	-	500,000	250,000	50,000	(300,000)
Common stock issued in exchange for consulting services by noteholders at \$0.50 per share in October 2004	-	-	532,500	266,250	-	-
Common Stock issued pursuant to subscription at \$0.50 share in October 2004	-	-	500,000	250,000	-	-
Common Stock issued pursuant to subscription at \$0.45 share in October 2004	-	-	1,000,000	500,000	(50,000)	(450,000)
Common stock issued in exchange for consulting services by noteholders at \$0.45 per share in October 2004	-	-	315,000	157,500	(15,750)	-
Common Stock issued in exchange for consulting services at \$0.47 share in November 2004	-	-	100,000	50,000	(3,000)	-
Common Stock issued in exchange for consulting services at \$0.80 share in November 2004	-	-	300,000	150,000	90,000	-
Common Stock issued in exchange for consulting services at \$1.44 share in November 2004	-	-	115,000	57,500	108,100	-
Common Stock issued in exchange for employee services at \$1.44 share in November 2004	-	-	5,000	2,500	4,700	-

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH

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MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
	-----	-----	-----	-----	-----	-----
Common Stock issued in exchange for employee services at \$0.60 share in November 2004	-	-	60,000	30,000	6,000	(4,000)
Beneficial Conversion discount relating to Notes Payable	-	-	-	-	936,541	-
Beneficial Conversion Feature relating to Warrants	-	-	-	-	528,459	-
Common stock issued at \$0.016 in exchange for note payable in December 2004			5,500,000	2,750,000	(2,661,500)	
Common Stock issued in exchange for consulting services at \$1.44 share in December 2004	-	-	5,796,785	2,898,393	5,418,814	-
Common stock issued pursuant to subscription at \$0.50 per share in December 2004	-	-	2,930,000	1,465,000	-	(125,000)
Warrants issued to consultants in December 2004	-	-			394,698	
Warrants exercised at \$0.10 per share in January 2005	-	-	25,000	12,500	(10,000)	-
Common Stock issued in settlement of debt at \$0.33 per share in January 2005	-	-	1,628,789	814,395	(276,895)	-
Warrants exercised at \$0.10 per share in January 2005	-	-	17,500	8,750	(7,000)	-
Common Stock issued in settlement of debt at \$0.33 per share in January 2005	-	-	2,399,012	1,199,503	(407,830)	-
Common Stock issued in						

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exchange for consulting services at \$1.30 per share in January 2005	-	-	315,636	157,818	252,509	-
Common Stock issued in settlement of debt at \$0.33 per share in February 2005	-	-	75,757	37,879	(12,879)	-

See accompanying notes to unaudited condensed consolidated financial statements

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A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICI  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUG  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
	-----	-----	-----	-----	-----	-----
Warrants exercised at \$0.10 per share in February 2005	-	-	20,000	10,000	(8,000)	-
Common Stock issued in settlement of debt at \$0.33 per share in February 2005	-	-	606,060	303,030	(103,030)	-
Warrants exercised at \$0.10 per share in February 2005	-	-	45,000	22,500	(18,000)	-
Common Stock issued in settlement of debt at \$0.40 per share in February 2005	-	-	1,500,000	750,000	(150,000)	-
Common Stock issued in settlement of debt at \$0.33 per share in February 2005	-	-	278,433	139,217	(47,334)	-
Common Stock issued in exchange for consulting services at \$1.17 per share in February 2005	-	-	17,236	8,618	11,548	-
Common stock issued pursuant to subscription at \$0.50 per share in February 2005	-	-	300,000	150,000	-	-



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Common Stock issued in exchange for consulting services at \$0.95 per share in February 2005	-	-	716,500	358,250	322,425	-
Common Stock issued in exchange for consulting services at \$0.95 per share in February 2005	-	-	10,500	5,250	4,725	-
Common stock issued pursuant to subscription at \$0.50 per share in March 2005	-	-	13,202,000	6,601,000	-	-
Common Stock issued in exchange for consulting services at \$1.19 per share in March 2005	-	-	185,000	92,500	127,650	-
Options exercised at \$0.60 per share in March 2005	-	-	100,000	50,000	10,000	-
Common Stock issued in exchange for consulting services at \$0.98 per share in March 2005	-	-	1,675,272	837,636	804,131	-

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
	-----	-----	-----	-----	-----	-----
Common Stock issued in exchange for consulting services at \$0.92 per share in March 2005	-	-	24,333	12,167	10,219	-
Common Stock issued in exchange for consulting services at \$0.99 per share in March 2005	-	-	15,000	7,500	7,350	-
Common stock issued						

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pursuant to subscription at \$0.50 per share in March 2005	-	-	1,240,000	620,000	-	-
Common stock canceled For shares issued in exchange of debt in March 2005	-	-	(500,000)	(250,000)	-	-
Common stock subscribed Canceled in March 2005	-	-	-	-	-	750,000
Common Stock issued in exchange for consulting services at \$0.89 per share in March 2005	-	-	10,000	5,000	3,900	-
Adjust common stock par value from \$0.50 to \$0.001 per share, per amendment of articles dated March 2005	-	-	-	(32,312,879)	32,312,879	-
Beneficial Conversion discount relating to Notes Payable in March 2005	-	-	-	-	4,179,554	-
Beneficial Conversion Feature relating to Warrants in March 2005	-	-	-	-	3,191,446	-
Stock options granted to employees in exchange for services rendered, at exercise price below fair value of common stock in March 2005	-	-	-	-	180,000	-
Common Stock issued in exchange for consulting services at \$0.80 per share in April 2005	-	-	160,000	160	127,840	-
Common Stock issued in exchange for consulting services at \$0.80 per share in April 2005	-	-	40,000	40	31,960	-

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)

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(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
	-----	-----	-----	-----	-----	-----
Common Stock issued in exchange for consulting services at \$0.75 per share in April 2005	-	-	850,000	850	636,650	-
Common Stock issued in exchange for consulting services at \$0.33 per share in April 2005	-	-	500,000	500	164,500	-
Common Stock canceled during April 2005, previously issued for services rendered at \$3.42 per share	-	-	(10,000)	(10)	(34,190)	-
Common Stock issued in settlement of debt at \$0.33 per share in April 2005	-	-	75,758	77	24,923	(25,000)
Common Stock issued in exchange for consulting services at \$0.68 per share in April 2005	-	-	50,000	50	33,950	-
Proceeds received against subscription Payable in June 2005	-	-	-	-	-	118,000
Common Stock canceled in June 2005, previously issued for services rendered at \$0.50 per share	-	-	(10,000)	(10)	(4,990)	-
Cancellation of previously granted stock options granted to employees for services rendered, at exercise price below fair value of common stock	-	-	-	-	(180,000)	-
Warrants issued to consultants and Employees during the quarter ended June 30, 2005	-	-	-	-	849,046	-
Common Stock issued in exchange for consulting services at \$0.60 per share in July 2005	-	-	157,000	157	94,043	-
Common Stock issued in						

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exchange for intellectual property at \$0.67 per share in July 2005	-	-	36,000,000	36,000	24,084,000	-
Common Stock issued in exchange for consulting services at \$0.60 per share in July 2005	-	-	640,000	640	383,360	-
Common Stock issued in exchange for employee services at \$0.48 per share in July 2005	-	-	8,000,000	8,000	3,832,000	-

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIT)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
	-----	-----	-----	-----	-----	-----
Common Stock issued in exchange for consulting services at \$0.48 per share in August 2005	-	-	250,000	250	119,750	-
Common Stock issued in exchange for consulting services at \$0.94 per share in September 2005	-	-	121,985	122	168,217	-
Common Stock penalty shares issued pursuant to pending SB-2 registration at \$0.62 per share in September 2005	-	-	814,158	814	501,858	-
Common Stock penalty shares issued pursuant to pending SB-2 registration at \$0.70 per share in September 2005	-	-	391,224	391	273,466	-
Common Stock issued in exchange for consulting services at \$0.94 per share in September 2005	-	-	185,000	185	173,715	-

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Common Stock returned in September 2005, previously issued for services rendered at \$0.40 per share	-	-	(740,000)	(740)	(353,232)	56,000
Adjustment to warrants previously issued and canceled during the year ended Sept 30, 2005	-	-	-	-	(287,440)	-
Cumulative effect of Warrant revaluation	-	-	-	-	7,005,371	-
Net Loss	-	-	-	-	-	-
Balance as of September 30, 2005	60,000	\$ 6	112,230,392	\$ 112,230	\$88,885,173	\$ 20,000

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIENCY)  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed
Common stock issued pursuant to subscription at \$0.50 per share in October 2005	-	-	400,000	400	199,600	(200,000)
Common Stock issued in exchange for consulting services at \$0.75 per share in October 2005	-	-	100,000	100	74,900	-
Common Stock returned in October 2005, previously issued for services rendered at \$0.60 per share	-	-	(350,000)	(350)	(209,650)	-
Common stock issued pursuant to subscription at \$0.50 per share in December 2005	-	-	40,000	40	19,960	(20,000)

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Common Stock penalty shares issued pursuant to pending SB-2 registration at \$0.51 per share in December 2005	-	-	505,854	506	257,481	-
Fair value related to warrants issued in November 2005	-	-	-	-	563,750	-
Effect of Warrant Revaluation	-	-	-	-	(1,758,900)	-
Net Loss	-	-	-	-	-	-
Balance as of December 31, 2005	60,000	\$ 6	112,926,246	\$ 112,926	\$88,032,313	\$(200,000)

See accompanying notes to unaudited condensed consolidated financial statements

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APPLIED DNA SCIENCES, INC  
(A development stage company)  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY, (DEFICIE  
FOR THE PERIOD SEPTEMBER 16, 2002 (DATE OF INCEPTION) THROUGH  
MARCH 31, 2006 (Unaudited)  
(Continued)

	Preferred Shares	Preferred Shares Amount	Common Shares	Common Stock Amount	Additional Paid in Capital Amount	Common Stock Subscribed	Stock Subscrip Recei
Common Stock returned in January 2006, previously issued for services rendered at \$0.60 per share			(250,000)	(250)	(149,750)		
Penalty shares issued pursuant to pending SB-2 registration at \$0.32 per share in January 2006			806,212	806	257,182		
Penalty shares issued pursuant to pending SB-2 registration at \$0.20 per share in January 2006			1,289,927	1,290	256,695		
Warrants issued in January 2006					43,100		
Common Stock							

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issued in exchange for consulting services at \$0.17 share in February 2006			160,000	160	27,040		
Common Stock issued in exchange for consulting services at \$0.16 share in February 2006			3,800,000	3,800	604,200		
Common Stock returned in March 2006, previously issued for services rendered at \$0.80 per share Valuation of Warrant			(150,000)	(150)	(119,850)		
Liabilities in connection with Private Placement (Note C)					(730,111)		
Net Loss							
Balance as of March							
31, 2006	----- 60,000 =====	--- 6 ===	----- 118,582,385 =====	----- \$ 118,582 =====	----- \$88,220,817 =====	----- \$(200,000) =====	----- \$ - =====

See accompanying notes to unaudited condensed consolidated financial s

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(A DEVELOPMENT STAGE COMPANY)  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	For the Six Months March 31, 2006
Net cash used in operating activities	\$(1,508,503)
Net cash used in investing activities	(44,972)
Net cash provided by financing activities	1,600,000
Net increase in cash and cash equivalents	46,525
Cash and cash equivalents at beginning of period	31,190
Cash and cash equivalents at end of period	\$ 77,715

Supplemental Disclosures of Cash Flow Information:

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Cash paid during period for interest	--
Cash paid during period for taxes	--
Non-cash transaction	
Common stock issued for services	710,200
Common stock issued in exchange for intellectual property	--
Common stock issued in exchange for previously incurred debt	
Common stock penalty shares issued pursuant to pending SB-2 registration	773,958
Common stock canceled-previously issued for services rendered	(480,000)
Common stock retired	
Amortization of beneficial conversion feature	--
Preferred Shares in exchange for services	--
Warrants issued to consultants	606,850
Acquisition:	
Common stock retained	--
Assets acquired	--
Total consideration paid	--
Organization expenses - note issued in exchange of shares retired	--

See accompanying notes to unaudited condensed consolidated financial s

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APPLIED DNA SCIENCES, INC  
(A DEVELOPMENT STAGE COMPANY)  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL INFORMATION  
MARCH 31, 2006  
(UNAUDITED)

### NOTE A - SUMMARY OF ACCOUNTING POLICIES

#### Basis of Presentation

The accompanying unaudited consolidated financial statements as of March 31, 2006 and for the six month periods ended March 31, 2006 and 2005 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"), including Form 10-QSB and Regulation S-B. The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments), which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally present in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations. The Company believes that the disclosures provided are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the audited financial statements and explanatory notes for the year ended September 30, 2005 as disclosed in the company's 10-KSB for that year as filed with the SEC, as it may be amended.

The results of the six month period ended March 31, 2006 are not necessarily indicative of the results to be expected for the full year ending September 30, 2006.

#### Estimates

The preparation of the financial statements in conformity with generally



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accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

### Business and Basis of Presentation

On September 16, 2002, Applied DNA Sciences, Inc. (the "Company") was incorporated under the laws of the State of Nevada. The Company is in the development stage, as defined by Statement of Financial Accounting Standards No. 7 ("SFAS No. 7") and its efforts have been principally devoted to developing DNA embedded biotechnology security solutions in the United States. To date, the Company has generated nominal sales revenues, has incurred expenses and has sustained losses. Consequently, its operations are subject to all the risks inherent in the establishment of a new business enterprise. For the period from inception through March 31, 2006, the Company has accumulated losses of \$89,804,818.

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated in the consolidated financial statements.

### Reclassification

Certain prior period amounts have been reclassified for comparative purposes.

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### Stock-Based Compensation

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123R (revised 2004), "Share-Based Payment" which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation". Statement 123R supersedes APB opinion No. 25, "Accounting for Stock Issued to Employees", and amends FASB Statement No. 95, "Statement of Cash Flows". Generally, the approach in Statement 123R is similar to the approach described in Statement 123. However, Statement 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro-forma disclosure is no longer an alternative. This statement does not change the accounting guidance for share based payment transactions with parties other than employees provided in Statement of Financial Accounting Standards No. 123(R). This statement does not address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans." On April 14, 2005, the SEC amended the effective date of the provisions of this statement. The effect of this amendment by the SEC is that the Company had to comply with Statement 123R and use the Fair Value based method of accounting no later than the first quarter of 2006. The Company implemented SFAS No. 123(R) on January 1, 2006 using the modified prospective method. The fair value of each option grant issued after January 1, 2006 will be determined as of grant date, utilizing the Black-Scholes option pricing model. The amortization of each option grant will be over the remainder of the vesting period of each option grant.

As more fully described in financial statements as included in Form 10-KB for the year ended September 30, 2005, the Company granted stock options over the years to employees of the Company under a non-qualified employee stock option plan. As of September 30, 2005, 3,660,000 options were outstanding and exercisable. The Company did not grant any stock options to employees during the

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quarter ended March 31, 2006. The Company did not recognize compensation expense related to employees stock options in the quarter ended March 31, 2006. The impact on earnings for the remainder of fiscal 2006 for stock based compensation will depend on future stock option issuances.

In prior years, the Company applied the intrinsic-value method prescribed in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," to account for the issuance of stock options to employees and accordingly compensation expense related to employees' stock options were recognized in the prior year financial statements to the extent options granted under stock incentive plans had an exercise price less than the market value of the underlying common stock on the date of grant.

Had compensation costs for the Company's stock options been determined based on the fair value at the grant dates for the awards, the Company's net loss and loss per share would have been as follows:

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	For the six months ended	
	March 31, 2006	March 31, 2005
Net income (loss) attributable to common stockholders -as reported and restated	\$ 9,039,717	\$(34,549,004)
Add:		
Total stock based employee compensation expense as reported under intrinsic value method (APB No. 25)	-	-
Deduct:		
Total stock based employee compensation expense as reported under fair value based method (SFAS No. 123)	-	-
Net Income (loss) -Pro Forma	\$ 9,039,717	(34,549,004)
Net Income (loss) attributable to common stockholders - Pro forma	\$ 9,039,717	(34,549,004)
Basic income (loss) per share -as reported	\$ 0.08	\$ (0.86)
Basic income (loss) per share - Pro forma	\$ 0.08	\$ (0.86)
Diluted income (loss) per share -as reported	\$ 0.08	\$ (0.86)
Diluted income (loss) per share - Pro forma	\$ 0.08	\$ (0.86)

### Derivative Financial Instruments

The Company's derivative financial instruments consist of embedded derivatives related to the 10 % Secured Convertible Promissory Notes (the "Serial Notes") entered into on March 7, 2006, 2006 (see Note D). These embedded derivatives include certain conversion features, variable interest features, call options and default provisions. The accounting treatment of derivative financial instruments requires that the Company record the derivatives and related warrants at their fair values as of the inception date of the Note Agreement (estimated at \$858,600) and at fair value as of each subsequent balance sheet date. In addition, under the provisions of EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," as a result of entering into the Notes, the Company is required to classify all other non-employee stock options and warrants as derivative liabilities and mark them to market at each reporting

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date. The fair value of such options and warrants that were reclassified as liabilities from additional paid-in capital at March 31, 2006 totaled \$730,111. Any change in fair value will be recorded as non-operating, non-cash income or expense at each reporting date. If the fair value of the derivatives is higher at the subsequent balance sheet date, the Company will record a non-operating, non-cash charge. If the fair value of the derivatives is lower at the subsequent balance sheet date, the Company will record non-operating, non-cash income. Conversion-related derivatives were valued using the Binomial Option Pricing Model with the following assumptions: dividend yield of 0%; annual volatility of 157.55%; and risk free interest rate of 4.82% as well as probability analysis related to trading volume restrictions. The remaining derivatives were valued using discounted cash flows and probability analysis. The derivatives are classified as long-term liabilities (see Note F).

### New Accounting Pronouncements

FAS 129-1. In April 2004, the FASB issued FASB Staff Position (FSP) 129-1, "Disclosure Requirements under SFAS 129, "Disclosure of Information about Capital Structure," Relating to Contingently Convertible Securities." The FSP interprets how the disclosure provisions of SFAS 129 apply to contingently convertible securities and their potentially dilutive effect on earnings per share. The Company is in a loss position for the three and nine months ended October 2, 2004, therefore, adoption of this FSP did not have a material effect on the Company's financial position, results of operations, or cash flows.

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Staff Accounting Bulletin No. 107. In March 2005, the staff of the SEC issued Staff Accounting Bulletin No. 107 (" SAB 107 "). The interpretations in SAB 107 express views of the staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provide the staff's views regarding the valuation of share-based payment arrangements for public companies. In particular SAB 107 provides guidance related to share-based payment transactions with nonemployees, the transition from public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of SFAS 123(R) and disclosures in Management's Discussion and Analysis subsequent to adoption of SFAS 123(R).

SFAS 154. In May 2005 the FASB issued Statement of Financial Accounting Standards (SFAS) No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3." SFAS 154 requires retrospective application to prior periods' financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle, such as a change in non-discretionary profit-sharing payments resulting from an accounting change, should be recognized in the period of the accounting change. SFAS 154 also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and corrections of errors

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made in fiscal years beginning after the date this Statement is issued. The Company does not expect the adoption of this SFAS to have a material impact on its consolidated financial position, results of operations or cash flows.

### NOTE B - INTANGIBLE ASSET AMORTIZATION

The Company has adopted SFAS No. 142, Goodwill and Other Intangible Assets, whereby the Company periodically test its intangible assets for impairment. On an annual basis, and when there is reason to suspect that their values have been diminished or impaired, these assets are tested for impairment, and write-downs will be included in results from operations.

On July 12, 2005, the Company acquired certain intellectual properties from Biowell Technology, Inc. ("Biowell") through an Asset Purchase Agreement ("Agreement") in exchange for 36 million shares of the Company's restricted common stock having an aggregate fair value at the date of issuance of \$24,120,000. The value of the acquired intangible assets was \$9,430,900, with the balance of the purchase price, or \$14,689,100, charged to operations as a cost of the transaction.

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The identifiable intangible assets acquired and their carrying value at March 31, 2006 are:

Amortizable Intangible Assets	Gross Carrying Amount	Accumulated Amortization	Net	Weighted Average Amortization Residual Value	Period (Years)
Trade secrets and developed technologies	9,430,900	1,010,454	8,420,446	--	7
Patents	34,257	15,168	19,089	--	5
	-----	-----	-----	-----	-----
Total Amortized Identifiable Intangible Assets	\$ 9,465,157	\$ 1,025,622	\$8,439,535	--	6.99
	=====	=====	=====	=====	=====

Total amortization expense charged to operations for the six months ended March 31, 2006 and 2005 were \$ 677,040 and \$7,306 respectively.

### NOTE C - NOTES PAYABLE

Notes payable at March 31, 2006 consist of the following:

10% Secured Convertible Promissory Notes , net of unamortized debt discount of \$ 823,210 (see below)	\$ 676,790
4% convertible note payable, unsecured, and due August 1, 2005; currently in default; Noteholder has the option to convert unpaid principal together with accrued and unpaid interest to 180,000 shares of the Company's restricted common stock. The Company is in default under	

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the terms of the Note Agreements.	410,429
7.5% note payable to BioCogent, Ltd., an entity controlled by the Company's President and CEO ; unsecured and repayment of principal and accrued and unpaid interest due upon the earlier of the (i) receipt by the Company of \$250,000 in debt or, equity or other infusion of capital or (ii) by June 30, 2006.	100,000
	-----
	1,187,219
Less : Current portion	(510,429)
	\$ 676,790

### 10% Secured Convertible Promissory Notes

On March 8, 2006, in connection with a private placement, the Company issued 10% Secured Convertible Promissory Notes in the aggregate principal amount of \$1,500,000 (the "Serial Notes") and warrants to purchase 3,000,000 shares of the Company's common stock to accredited investors. The Serial Notes bear interest at 10%, mature on September 7, 2007 and are convertible into the Company's common stock, at the holder's option, at fifty cents (\$.50) per share during the period from the date of issuance (March 8, 2006) through March 7, 2007. Should the holder of the Serial Note elect not to convert to the Company's common stock on or before March 7, 2007, the outstanding principal, along with accrued and unpaid interest automatically converts to the Company's common stock at an amount equal to 80% of the average bid price of the Company's common stock on the Over-The-Counter Bulletin Board for a period equal to ten (10) days prior to conversion on the maturity date of September 7, 2007. The full principal amount of the Serial Notes is due upon a default under the terms of the Note Agreement. In addition, the Company granted the Investors a security interest in all of its assets (see Note B). The Company agreed to file a registration statement with the SEC to effect the registration of the shares of its common stock underlying the Serial Notes and the warrants within 30 days of the effective date of the Company's pending Registration Statement (SEC File 333 - 122848) being declared effective. The Company also agreed to use its reasonable best efforts to cause the registration statement to be declared effective no later than 180 days after its filing. If the Registration Statement is not filed and declared effective as described above, the Company will be required to pay liquidated damages in the form of cash to the holders of the Serial Notes , in an amount equal to 2% of the unpaid principal balance per month if the above deadlines are not met. In the event of a default on the Serial Notes, the Serial Notes will bear interest at twelve percent (12%) per annum until paid.

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The warrants are exercisable until five years from March 8, 2006 until March 7, 2011 at a price of \$0.50 per share. The Company has the right, but not the obligation, to call these warrents for \$1.25 per share at the earlier of (i) one year from issuance or (ii) the date that shares of common stock issuable upon conversion of the Serial Notes and exercise of the warrants are registered for resale and the Company's common stock trades at or above \$1.25 per share for twenty (20) consecutive trading days. The Company may exercise its right of redemption by written notice to the registered holder of the warrant together with payment of \$1.25 or its British Sterling equivalent. The Notes include certain features that are considered embedded derivative financial instruments, such as a variety of conversion options, a variable interest rate feature, events of default and a variable liquidated damages clause.

The initial relative fair value assigned to the embedded derivatives was \$346,500.

In conjunction with the Notes, the Company issued warrants to purchase

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3,000,000 shares of common stock. The accounting treatment of the derivatives and warrants requires that the Company record the warrants at their fair values as of the inception date of the debt issuance, which totaled \$512,100.

The Company recorded the fair value of the derivatives (\$346,500) and warrants (\$ 512,100) to debt discount, aggregating \$858,600, which will be amortized to interest expense over the term of the Notes. Amortization of \$35,390 was recorded for the three months ended March 31, 2006.

The market price of the Company's common stock significantly impacts the extent to which the Company may be required or may be permitted to convert the Serial Notes into shares of the Company's common stock. The lower the market price of the Company's common stock at the due date of September 7, 2007, the more shares the Company will need to issue to convert the principal and interest payments then due on the Notes.

Future minimum principal payments are as follows under notes payable for the year ending March 31, 2006:

2006	\$ 510,429
2007	1,500,000
	-----
	\$ 2,010,429

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### NOTE D - CAPITAL STOCK

The Company is authorized to issue 10,000,000 shares of preferred stock with a \$.001 par value per share. The Company is authorized to issue 250,000,000 shares of common stock, with a \$0.001 par value per share as the result of a shareholder meeting conducted on February 14, 2005. Prior to the February 14, 2005 share increase and par value change, the Company had 100,000,000 authorized shares with a par value of \$0.50. In February 2005, the Company passed a resolution authorizing change in the par value per common shares from \$0.50 per share to \$0.001 per share.

During the period September 16, 2002 through September 30, 2003, the Company issued 100,000 shares of common stock in exchange for reimbursement of services provided by the founders of the Company. The Company valued the shares issued at approximately \$1,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In October, 2002, the Company issued 10,178,352 shares of common stock in exchange for the previously issued 100,000 shares to the Company's founders in connection with the merger with Prohealth Medical Technologies, Inc.

In October, 2002 the Company canceled 100,000 shares of common stock issued to the Company's founders.

In October 2002 the Company issued 602,000 shares of common stock in exchange for services valued at \$0.065 per share. In accordance with EITF 96-18 the measurement date to determine fair value was in October 2002. This was the date at which a commitment for performance by the counter party to earn the equity instrument was reached. The Company valued the shares issued at approximately \$0.065 per share, which presents the fair value of the services received which did not differ materially from the value of the stock issued.

In November and December 2002, the Company issued 876,000 shares of

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common stock in exchange for subscription at \$0.065 per share. In accordance with EITF 96-18 the measurement date to determine fair value was in October 2002. This was the date at which a commitment for performance by the counter party to earn the equity instrument was reached. The Company valued the shares issued at approximately \$0.065 per share, which presents the fair value of the services received which did not differ materially from the value of the stock issued.

In January 2003, the Company canceled 836,000 shares of common stock previously issued in exchange for consulting services.

In January 2003, the Company issued 1,500,000 shares of common stock in exchange for a licensing agreement. The Company valued the shares issued at approximately \$0.065 per share, which represents the fair value of the license received which did not differ materially from the value of the stock issued. The Company charged the cost of the license to operations.

In January 2003, the Company issued 586,250 shares of common stock in exchange for consulting services. In accordance with EITF 96-18 the measurement date to determine fair value was in October 2002. This was the date at which a commitment for performance by the counter party to earn the equity instrument was reached. The Company valued the shares issued at approximately \$0.13 per share, which presents the fair value of the services received which did not differ materially from the value of the stock issued.

In February 2003, the Company issued 9,000 shares of common stock in exchange for consulting services. In accordance with EITF 96-18 the measurement date to determine fair value was in October 2002. This was the date at which a commitment for performance by the counter party to earn the equity instrument was reached. The Company valued the shares issued at approximately \$0.065 per share, which presents the fair value of the services received which did not differ materially from the value of the stock issued.

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In March 2003, the Company issued 10,140,000 shares of common stock to Company's founders in exchange for services. In accordance with EITF 96-18 the measurement date to determine fair value was in September 2002. This was the date at which a commitment for performance by the counter party to earn the equity instrument was reached. The Company valued the shares issued at approximately \$0.0001 per share, which presents the fair value of the services received which did not differ materially from the value of the stock issued.

In March 2003, the Company issued 91,060 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$2.53 per share, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In March 2003, the Company issued 6,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.065 per share, which represents the fair value of the services received which did not differ materially from the value of the stock issued. In March 2003, the Company received subscription for 18,000 shares of common stock in exchange for cash at \$1 per share.

On April 1, 2003, the Company issued 860,000 shares of common stock in exchange for consulting services provided to the Company. In accordance with EITF 96-18 the measurement date to determine fair value was in October 2002. This was the date at which a commitment for performance by the counter party to earn the equity instrument was reached. The Company valued the shares issued at

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approximately \$0.065 per share, which presents the fair value of the services received which did not differ materially from the value of the stock issued.

On April 9, 2003, the Company issued 18,000 shares of common stock in exchange for previously issued options to purchase the Company's common stock at \$1.00 per share.

On April 9, 2003, the Company issued 9,000 shares of common stock in exchange for consulting services provided to the Company. In accordance with EITF 96-18 the measurement date to determine fair value was in October 2002. This was the date at which a commitment for performance by the counter party to earn the equity instrument was reached. The Company valued the shares issued at approximately \$0.065 per share, which presents the fair value of the services received which did not differ materially from the value of the stock issued.

On April 23, 2003, the Company issued 5,000 shares of common stock in exchange for consulting services provided to the Company. The Company valued the shares issued at approximately \$2.50 per share, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

On June 12, 2003, the Company issued 10,000 shares common stock in exchange for consulting services provided to the Company. The Company valued the shares issued at approximately \$2.50 per share, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

On June 17 2003, the Company issued 50,000 shares of common stock in exchange for cash at \$1.00 per share.

On June 30, 2003, the Company issued 270,000 shares of common stock in exchange for consulting services provided to the Company. In accordance with EITF 96-18 the measurement date to determine fair value was in October 2002. This was the date at which a commitment for performance by the counter party to earn the equity instrument was reached. The Company valued the shares issued at approximately \$0.065 per share, which presents the fair value of the services received which did not differ materially from the value of the stock issued.

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On June 30, 2003, the Company received \$10,000 as subscription for options to purchase the Company's common stock at \$1.00 per share.

In June, 2003, the Company received \$48,000 in connection with a subscription to purchase the Company's common stock pursuant to a private placement.

In connection with the Company's acquisition of ProHealth, the controlling owner of ProHealth granted the Company an option to acquire up to 8,500,000 shares of the Company's common stock in exchange for \$100,000 . The option expired on December 10, 2004. On June 30, 2003, the Company exercised its option and acquired 7,500,000 common shares under this agreement in exchange for an \$88,500 convertible promissory note payable to the former controlling owner. The Company had an option through December 10, 2004 to acquire the remaining 1,000,000 shares from the former controlling owner in exchange for \$11,500. On June 30, 2003, the Company retired the 7,500,000 shares common acquired pursuant to the option agreement.

In July 2003 the Company issued 213,060 shares of common stock for consulting services provided to the Company. The Company valued the shares issued at approximately \$2.01 per share, which represents the fair value of the



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services received which did not differ materially from the value of the stock issued.

In July 2003, the Company canceled 24,000 shares of common stock, previously issued for services valued at \$2.50 per share.

In July 2003, the Company received \$20,000 in exchange for previously issued options to purchase the Company's common stock at \$1.00 per share.

In July 2003, the Company issued 10,000 shares of common stock for cash previously subscribed at \$1.00 per share.

In August 2003, the Company issued 172,500 shares of common stock in exchange for consulting services provided to the Company. The Company valued the shares issued at approximately \$2.38 per share, which represents the fair value of the services received which did not differ materially from the value of the stock issued

In August 2003, the Company received \$29,000 in exchange for previously issued options to purchase the Company's common stock at \$1.00 per share.

In September 2003, the Company issued 395,260 shares of common stock in exchange for consulting services provided to the Company. The Company valued the shares issued at approximately \$2.42 per share, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In September 2003, the Company issued 19,200 shares of common stock for cash previously subscribed at \$2.50 per share.

In September 2003, the Company issued 6,400 shares of common stock issued in exchange for cash at \$2.50 per share pursuant to private placement.

In September 2003, the Company received \$95,000 in exchange for previously issued options to purchase the Company's common stock at \$1.00 per share.

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In September 2003, the Company received \$2,600 in connection with a subscription to purchase the Company's common stock pursuant to a private placement.

The Company valued the shares issued for consulting services at the rate which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In October 2003, the Company issued 15,000 shares of convertible preferred stock in exchange for services. The Company valued the shares issued at the \$15 par value and recorded the value for services when the shares were converted into common shares as identified below.

In October 2003, the Company issued 287,439 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$2.85 per share for a total of \$820,418, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In October 2003, the Company issued 120,000 shares of common stock for shares previously subscribed at \$2.50 per share in September 2003. In October

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2003, the Company canceled 100,000 shares of common stock previously issued in exchange for services at \$2.50 per share.

In November 2003, the Company issued 100,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$3.00 per share, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In November 2003, the Company sold 100,000 shares of common stock subscribed for cash at \$2.50 per share pursuant to private placement.

In December 2003, the Company sold 6,400 shares of common stock subscribed for cash at \$2.50 per share pursuant to private placement.

In December 2003, the Company issued 2,125,500 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$2.59 per share, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In December 2003, the Company received \$104,000 in exchange for a common stock subscription at \$2.50 per share pursuant to private placement.

In January 2004, the Company issued 41,600 shares of common stock at \$2.50 share pursuant to a subscription made on December 2003.

In January 2004, the Company issued 13,040 shares of common stock at \$2.95 per share in exchange for consulting services valued at \$38,468.

In January 2004, the Company issued 123,000 shares of common stock at \$2.60 per share in exchange for consulting services valued at \$319,800.

In January 2004, the Company issued 1,000 shares of common stock at \$3.05 per share in exchange for consulting services valued at \$3,050.

In February 2004, the Company issued 6,283 shares of common stock at \$3.07 per share in exchange for employee services valued at \$19,288.

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In March 2004, the Company issued 44,740 shares of common stock at \$3.04 per share in exchange for consulting services valued at \$136,010.

In March 2004, the Company issued 55,000 of common stock for options exercised at \$1.00 per share.

In March 2004, the Company issued 5,443 shares of common stock at \$3.00 per share in exchange for employee services valued at \$16,344.

In March 2004, the Company issued 5,769 shares of common stock at \$3.15 per share in exchange for employee services valued at \$18,177.

In March 2004, the Company converted 5,000 preferred shares into 125,000 shares of common stock at \$3.00 per share in exchange for employee services valued at \$375,000.

In March 2004, the Company issued 8,806 shares of common stock at \$3.03 per share in exchange for employee services valued at \$26,639.

In April 2004, the Company issued 22,500 shares of common stock at \$0.10 for subscription of warrants to be exercised.

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In April 2004, the Company issued 9,860 shares of common stock at \$2.58 per share in exchange for employee services valued at \$25,441.

In April 2004, the Company issued 11,712 shares of common stock at \$2.35 per share in exchange for consulting services valued at \$27,523.

In April 2004, the Company issued 367,500 shares of common stock at \$1.50 per share in exchange for consulting services valued at \$551,250.

In April 2004, the Company retired 50,000 shares of common stock previously issued for consulting services at \$0.065 per share or \$3,250.

In May 2004, the Company converted 4,000 preferred shares into 100,000 shares of common stock at \$1.01 per share in exchange for consulting services valued at \$101,250.

In May 2004, the Company issued 10,000 shares of common stock at \$0.10 per share in a stock subscription for \$1,000.

In May 2004, the Company issued 137,000 shares of common stock at \$0.86 per share in exchange for consulting services valued at \$119,233.

In May 2004, the Company issued 26,380 shares of common stock at \$1.15 per share in exchange for consulting services valued at \$30,337.

In June 2004, the Company retired 5,000 shares of common stock previously issued for consulting services at \$0.065 per share or \$325.

In June 2004, the Company issued 270,500 shares of common stock at \$0.67 per share in exchange for consulting services valued at \$180,560.

In June 2004, the Company issued 8,000 shares of common stock at \$0.89 per share in exchange for consulting services valued at \$7,120.

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In June 2004, the Company issued 50,000 shares of common stock at \$0.645 per share in exchange for consulting services valued at \$32,250.

In June 2004, the Company sold 250,000 shares of common stock at \$1.00 per share for total proceeds of \$250,000 pursuant to private placement.

In July 2004, the Company issued 100,000 shares of common stock at \$0.54 per share in exchange for consulting services valued at \$54,000.

In July 2004, the Company issued 5,000 shares of common stock at \$0.72 per share in exchange for consulting services valued at \$3,600.

In July 2004, the Company issued 100,000 shares of common stock at \$0.47 per share in exchange for consulting services valued at \$47,250.

In August 2004, the Company converted 2,000 preferred shares into 50,000 shares of common stock at \$0.39 in exchange for consulting services valued at \$19,500.

In August 2004, the Company issued 100,000 shares of common stock at \$0.39 in exchange for consulting services valued at \$39,000.

In August 2004, the Company issued 100,000 shares of common stock at \$0.50 in exchange for consulting services valued at \$50,250.

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In August 2004, the Company issued 200,000 shares of common stock at \$0.56 in exchange for consulting services valued at \$112,500.

In August 2004, the Company issued 92,500 shares of common stock at \$0.41 in exchange for consulting services valued at \$37,645.

In September 2004, the Company issued 1,000,000 shares of common stock at \$0.52 in exchange for consulting services valued at \$517,500.

In September 2004, the Company issued 45,000 shares of common stock at \$0.50 in exchange for consulting services valued at \$22,288.

In September 2004, the Company converted 4,000 preferred shares into 100,000 shares of common stock at \$0.54 in exchange for consulting services valued at \$54,000.

In September 2004, the Company issued 60,000 convertible preferred shares at \$25.00, in exchange for consulting services valued at \$1,500,000.

In October 2004, the Company issued 200,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.68 per share for a total of \$136,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In October 2004, shareholders returned 1,069,600 shares to treasury issued earlier in exchange for services valued at \$642,098.

In October 2004, the Company issued 82,500 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.60 per share for a total of \$49,500, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

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In October 2004, the Company sold 500,000 shares of common stock subscribed for cash at \$0.60 per share pursuant to private placement.

In October 2004, the Company issued 532,500 shares of common stock to existing noteholders. The Company valued the shares issued at approximately \$0.50 per share for a total of \$266,250.

In October 2004, the Company sold 500,000 shares of common stock subscribed for cash at \$0.50 per share pursuant to private placement.

In October 2004, the Company sold 1,000,000 shares of common stock subscribed for cash at \$0.45 per share pursuant to private placement.

In October 2004, the Company issued 315,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.45 per share for a total of \$141,750, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In November 2004, the Company issued 100,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.47 per share for a total of \$47,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

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In November 2004, the Company issued 300,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.80 per share for a total of \$240,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In November 2004, the Company issued 115,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$1.44 per share for a total of \$165,600, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In November 2004, the Company issued 5,000 shares of common stock in exchange for employee services. The Company valued the shares issued at approximately \$1.44 per share for a total of \$7,200, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In November 2004, the Company issued 60,000 shares of common stock in exchange for employee services. The Company valued the shares issued at approximately \$0.60 per share for a total of \$36,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In December 2004, the Company issued net 5,500,000 shares of common stock for default as per terms of notes payable for \$88,500. Out of total, 3,500,000 shares were retained in escrow on behalf of another party for future deferred compensation.

In December 2004, the Company issued 5,796,785 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$1.44 per share for a total of \$8,317,207, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In December 2004, the Company issued 2,930,000 shares of common stock subscribed for cash at \$0.50 per share pursuant to the exercise terms of a promissory note payable.

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During the three months ended March 31, 2005, the Company received \$10,750 in exchange for previously issued options to purchase the Company's common stock at \$ .10 per share.

In January 2005, the Company received \$2,500 in exchange for previously issued options to purchase the Company's common stock at \$ .10 per share.

In January 2005, we exchanged \$537,500 of previously issued convertible notes payable for 1,628,789 shares of common stock.

In January 2005, the Company received \$1,750 in exchange for previously issued options to purchase the Company's common stock at \$ .10 per share.

In January 2005, we exchanged \$791,673 of previously issued convertible notes payable for 2,399,012 shares of common stock.

In January, 2005, the Company issued 315,636 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$1.30 per share for a total of \$410,327, which represents the fair value of the services received which did not differ materially from the value of

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the stock issued.

In February 2005, we exchanged \$25,000 of previously issued convertible notes payable for 75,757 shares of common stock.

In February 2005, the Company received \$2,000 in exchange for previously issued options to purchase the Company's common stock at \$ .10 per share.

In February 2005, we exchanged \$200,000 of previously issued convertible notes payable for 606,060 shares of common stock.

In February 2005, the Company received \$ 4,500 in exchange for previously issued options to purchase the Company's common stock at \$ .10 per share.

In February 2005, we exchanged \$600,000 of previously issued convertible notes payable for 1,500,000 shares of common stock.

In February 2005, we exchanged \$91,883 of previously issued convertible notes payable for 278,433 shares of common stock.

In February, 2005, the Company issued 17,236 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$1.17 per share for a total of \$20,166, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In February, 2005, the Company exchanged \$150,000 of previously issued convertible notes payable for 300,000 shares of common stock .

In February, 2005, the Company issued 716,500 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.95 per share for a total of \$680,675, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In February, 2005, the Company issued 10,500 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.95 per share for a total of \$9,975, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

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In March, 2005, the Company exchanged \$ 6,601,000 of previously issued convertible notes payable for 13,202,000 shares of common stock.

In March, 2005, the Company issued 185,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$1.19 per share for a total of \$220,150, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In March 2005, the Company received \$ 60,000 in exchange for previously issued options to purchase the Company's common stock at \$ .60 per share.

In March, 2005, the Company issued 1,675,272 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.98 per share for a total of \$1,641,767, which represents the

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fair value of the services received which did not differ materially from the value of the stock issued.

In March, 2005, the Company issued 24,333 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.92 per share for a total of \$22,386, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In March, 2005, the Company issued 15,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.99 per share for a total of \$14,850, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In March, 2005, the Company exchanged \$ 620,000 of previously issued convertible notes payable for 1,240,000 shares of common stock.

In March, 2005, the Company canceled shares previously issued within the quarter for exchange of debt valued at \$250,000.

In March, 2005, the Company issued 10,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.89 per share for a total of \$8,900, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

The Company recognized an imbedded beneficial conversion feature present in the January/February Offering note ("January/February PPM"). The Company allocated a portion of the proceeds equal to the intrinsic value of that feature to additional paid in capital. The Company recognized and measured an aggregate of \$ 4,179,554 of the proceeds, which is equal to the intrinsic value of the imbedded beneficial conversion feature, to additional paid in capital and a discount against the Bridge Offering. Upon conversion of the debt to common stock, the debt discount attributed to the beneficial conversion feature was charged in full to operations as interest expense.

The Company recognized the value attributable to the warrants in the amount of \$3,191,446 to additional paid in capital and a discount against the January/February 2005 PPM.

For the year ended September 30, 2005, the Company reclassified the \$7,371,000 to Warrant Liability (see Note B).

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In March, 2005, the Company granted an aggregate of 300,000 stock options to employees that vested immediately. The exercise prices of the stock options granted were below the fair value of the Company's common stock at the grant date. Compensation expense of \$180,000 was charged to operations during the period ended March 31, 2005.

In April, 2005, the Company issued 160,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.80 per share for a total of \$128,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In April, 2005, the Company issued 40,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.80 per share for a total of \$32,000, which represents the fair

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value of the services received which did not differ materially from the value of the stock issued.

In April, 2005, the Company issued 850,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.75 per share for a total of \$637,500, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In April 2005, we exchanged \$165,000 of previously issued convertible notes payable for 500,000 shares of common stock. In April, 2005, a shareholder returned 10,000 shares previously issued for services valued at \$34,200 in exchange for a cash settlement.

In April 2005, we exchanged previously issued convertible notes payable for 75,758 shares of common stock.

In April 2005, the Company issued 50,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.68 per share for a total of \$34,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In June 2005, a shareholder returned 10,000 shares previously issued for services valued at \$5,000.

In June 2005, the Company cancelled 300,000 stock options previously granted valued at \$180,000.

In July 2005, the Company issued 157,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.60 per share for a total of \$94,200, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In July 2005, the Company issued 36 million shares in exchange for intellectual property at approximately \$0.67 per share for a total of \$24,120,000 (see Note C).

In July 2005, the Company issued 640,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.60 per share for a total of \$384,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In July 2005, the Company issued 8,000,000 shares of its common stock without restriction to employees in exchange for services rendered. . The Company valued the shares issued at approximately \$0.48 per share for a total of \$3,840,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued. Since the Company issued the shares without restriction, the Company may have violated federal and state securities laws in connection with the issuance of those shares (see Note I).

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In July 2005, the Company issued 121,985 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.94 per share for a total of \$168,339, which represents the fair value of the services received which did not differ materially from the value of the stock issued.



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In July 2005, the Company issued 250,000 shares of its common stock without restriction to consultants in exchange for services rendered. The Company valued the shares issued at approximately \$0.48 per share for a total of \$120,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued. Since the Company issued the shares without restriction, the Company may have violated federal and state securities laws in connection with the issuance of those shares (see Note I).

In connection with the \$7,371,000 convertible debt financing completed during the quarter ended March 31, 2005, the Company was obligated, pursuant to a registration rights agreement, to complete an effective registration statement with the SEC of the common stock underlying the convertible debt (see Note I). Pursuant to the registration rights agreement, the Company is obligated to pay the investors liquidated damages an amount equal to 3.5% of the face value amount of the previously issued convertible notes, or approximately \$258,000 per month should the registration statement not be declared effective by the SEC by July, 2005. The penalties may be paid in cash or shares of the Company's unregistered common stock, at the sole option of the Company.

As of the date of the financial statements, the registration statement has not been declared effective, and as a result the Company has incurred and charged to operations \$2,277,535 in liquidated damages. As of March 31, 2006, the Company has issued 3,807,375 shares of its restricted common stock representing \$1,503,540 of liquidated damages for failing to complete an effective registration statement. The Company valued the shares at the respective dates of issuance based upon the shares current market value. The balance due, or \$773,995 is included in accounts payable and accrued expenses as of March 31, 2006.

In September 2005, the Company issued 185,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.94 per share for a total of \$173,900, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

In September, 2005, the Company cancelled 740,000 shares previously issued for services valued at \$296,972.

In September, 2005, the Company cancelled warrants previously issued valued at \$287,440.

In October, 2005, the Company issued 400,000 shares of common stock in exchange for cash at \$0.50 per share for a total of \$200,000.

In October 2005, the Company issued 100,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.75 per share for a total of \$75,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued.

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In October 2005, the Company cancelled 350,000 shares previously issued for services valued at \$210,000.

In December, 2005, the Company issued 40,000 shares of common stock in exchange for cash at \$0.50 per share for a total of \$20,000.

In January, 2006, the Company cancelled 250,000 shares previously issued for services valued at \$150,000.

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In February 2006, the Company issued 160,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.17 per share for a total of \$27,200, which represents the fair value of the services received which did not differ materially from the value of the stock issued

In February 2006, the Company issued 3,800,000 shares of common stock in exchange for consulting services. The Company valued the shares issued at approximately \$0.16 per share for a total of \$608,000, which represents the fair value of the services received which did not differ materially from the value of the stock issued

In March, 2006, the Company cancelled 150,000 shares previously issued for services valued at \$120,000.

### NOTE E - STOCK OPTIONS AND WARRANTS

#### Warrants

The following table summarizes the changes in warrants outstanding and the related prices for the shares of the Company's common stock issued to shareholders of the Company. These warrants were granted in lieu of cash compensation for services performed or financing expenses in connection with the sale of the Company's common stock and placement of convertible debentures.

Exercise Prices	Warrants Outstanding			Warrants Exer	
	Number Outstanding	Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	We Av Ex
\$ .10	105,464	3.29	\$ .10	105,464	
.20	5,000	2.64	.20	5,000	
.50	8,550,000	4.72	.50	8,550,000	
.55	9,000,000	2.22	.55	9,000,000	
.60	9,132,000	3.13	.60	9,132,000	
.70	950,000	1.64	.70	950,000	
.75	17,727,000	3.50	.75	17,727,000	
1.00	100,000	0.55	1.00	100,000	
	-----			-----	
	45,569,464			45,569,464	
	=====			=====	

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Transactions involving warrants are summarized as follows:

Number of Shares	Weighted Average Price Per Share
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Balance, September 30, 2003	383,500	\$1.38
Granted	4,574,753	0.58
Exercised	(88,000)	1.00
Canceled or expired	-	-
	-----	-----
Balance, September 30, 2004	4,870,253	0.63
Granted	33,453,000	0.71
Exercised	(207,500)	0.34
Canceled or expired	(1,033,786)	0.65
	-----	-----
Balance, September 30, 2005	37,081,967	0.67
Granted	8,700,000	0.51
Exercised	-	-
Canceled or expired	(212,503)	1.31
	-----	-----
Balance, March 31, 2006	45,569,464	\$ 0.63
	=====	=====

In the quarter ended March 31, 2006, the Company issued 5,500,000 warrants to the holders of the Company's \$550,000 notes payable (see Note C) with a \$0.50 exercise price and a five year life. For the first 36 months, the warrants include anti dilution protection assuming no adjustment in the exercise price per share of Common Stock upon any reverse split of the Company's common stock. The estimated value of the warrants granted to Note holders was determined using the Black-Scholes pricing model and the following assumptions: contractual term of 5 years, a risk free interest rate of 4.55%, a dividend yield of 0% and volatility of 42.8%. The amount of the expense charged to operations for warrants was \$563,750 and \$394,698, respectively, for the three months ended March 31, 2006 and 2005.

Employee Stock Options

The following table summarizes the changes in options outstanding and the related prices for the shares of the Company's common stock issued to employees of the Company under a non-qualified employee stock option plan.

Options Outstanding			Options Exercisable		
Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
-----	-----	-----	-----	-----	-----
\$ .68	3,660,000	3.75	\$.68	3,660,000	\$.68

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Transactions involving stock options issued to employees are summarized as follows:

Number of Shares	Weighted Average Price Per Share
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Outstanding at October 1, 2003	-	\$ -
Granted	3,660,000	.68
Exercised	-	-
Cancelled or expired	-	-
Outstanding at September 30, 2005	3,660,000	\$ .68
Granted	-	-
Exercised	-	-
Cancelled or expired	-	-
Outstanding at March 31, 2006	3,660,000	\$ .68

Employee options outstanding and options exercisable at March 31, 2006 had no intrinsic value. Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the fiscal period, which was \$ .19 as of March 31, 2006, and the exercise price multiplied by the number of options outstanding. Total intrinsic value of options exercised was \$ 0 for the three-month periods ended March 31, 2006 and 2005, respectively. There was no unrecognized stock-based compensation expense related to non-vested stock options during the period ended March 31, 2006.

### NOTE F - WARRANT LIABILITY

In accordance with SFAS 133 "Accounting for Derivative Instruments and Hedging Activities and EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the Company has accounted warrants to purchase its common stock that provide for the payment of liquidated damages if the stipulated registration deadlines were not met as liabilities.

As of the date of this filing, the registration statement has not yet been declared effective by the SEC. The Company valued the warrants using the Black-Scholes option pricing model. and Hedging Activities," the Company revalued the warrants as of March 31, 2006 using the Black-Scholes option pricing model. Assumptions regarding the life were one to five years, expected dividend yield of 0%, a risk free rate of 4.82 % , and a volatility of 157.55%. The difference between the fair value of the warrants on September 30, 2005 and December 31, 2005 of \$ 16,413,750 and \$ 10,044,957, respectively, has been recorded as a gain on revaluation of warrant liability in the consolidated condensed statement of losses.

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### NOTE G- RELATED PARTY TRANSACTIONS

On July 15, 2005, we entered into a consulting agreement with Timpix International Limited ("Timpix") for the consulting services of three former Biowell employees, Drs. Jun-Jei Sheu, Ben Liang and Johnson Chen. The consulting agreement is for the shorter of two years, or until all of the consultants have obtained a visa to work in the United States and execute employment agreements with us. Such consulting agreement shall automatically renew for one year periods until terminated. Pursuant to the consulting agreement, we shall pay \$47,000 per month, which is apportioned at \$20,000 per month for Mr. Sheu, \$15,000 per month for Mr. Liang and \$12,000 per month for Mr. Chen. In the event that either of Messrs. Sheu, Liang or Chen becomes employed by us, the monthly consulting fee shall be reduced accordingly. We have negotiated an agreement in principle to restructure the Consulting Agreement, whereby, fees owed to Timpix from July 2005 through December 2005 will be waived, and salaries for each of the three consultants will be reduced starting January 1, 2006.

In July 2005, the Company entered into a license agreement with Biowell, whereby the Company granted Biowell an exclusive license to sell, market, and

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sub-license the Company's products in selected Asian countries. The exclusive license for such selected territories is for an initial period of until December 31, 2010, and if Biowell meets its performance goals, the license agreement will extend for an additional five year term. The license agreement gives Biowell the initial rights to future anti-fraud biotechnologies developed by the Company and also new applications for the existing technology that may be developed for the marketplace as long as the license agreement remains in effect. In the event that Biowell shall sub-license the products within its territories, Biowell shall pay the Company 50% of all fees, payments or consideration or any kind received in connection with the grant of the sublicense. Biowell is required to pay a royalty of 10% on all net sales made and is required to meet certain minimum annual net sales in its various territories. Cumulative royalties earned from the period July 2005 through March 31, 2006 totaled \$20,532 with \$3,128 occurring in the three months ended March 31, 2006.

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On March 29, 2006, and April 13, 2006, the Company borrowed \$200,000 in the aggregate, at a rate of 7.5% per annum, from BioCogent, Ltd., ("BioCogent"), an entity controlled by the Company's President and Chief Executive Officer. These loans are due and payable upon the earlier to occur of (1) the close of business on June 30, 2006, or (2) the closing of the issuance and sale by the Company of its securities for gross proceeds of at least \$250,000 (see Note C).

### NOTE H - COMMITMENTS AND CONTINGENCIES

#### Employment and Consulting Agreements

The Company has consulting agreements with outside contractors, certain of whom are also Company stockholders. The Agreements are generally month to month.

The Company has an employment agreement with the Company's President and Chief Executive Officer. In addition to salary provisions, the agreement includes defined commitments should the employee terminate the employment with or without cause.

On July 15, 2005, we entered into a consulting agreement with Timpix for the consulting services of three former Biowell employees, Drs. Jun-Jei Sheu, Ben Liang and Johnson Chen. The consulting agreement is for the shorter of two years, or until all of the consultants have obtained a visa to work in the United States and execute employment agreements with us. Such consulting agreement shall automatically renew for one year periods until terminated. Pursuant to the consulting agreement, we shall pay \$47,000 per month, which is apportioned at \$20,000 per month for Mr. Sheu, \$15,000 per month for Mr. Liang and \$12,000 per month for Mr. Chen. In the event that either of Messrs. Sheu, Liang or Chen becomes employed by us, the monthly consulting fee shall be reduced accordingly. We have negotiated an agreement in principle to restructure the Consulting Agreement, whereby, fees owed to Timpix from July 2005 through December 2005 will be waived, and salaries for each of the three consultants will be reduced starting January 1, 2006.

#### Litigation

On or about November 24, 2004, Oceanic Consulting, S.A. filed a complaint against the Company in the Superior Court of the State of New York. The Complaint alleges a breach of contract. Subsequent to the date of the financial statements, the Company and the Plaintiff settled the dispute and the Company has recorded the settlement amount as of March 31, 2006.

On or about January 10, 2005, Stern & Co. filed a complaint against the

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Company in the United States District Court for the Southern District of New York. The Complaint alleges a breach of contract. Subsequent to the date of the financial statements, the Company and the Plaintiff settled the dispute and the Company has recorded the settlement amount as of March 31, 2006.

On April 29, 2005, Crystal Research Associates, LLC obtained a default judgment against us for \$13,000 in the Superior Court of New Jersey, Middlesex County. The Company settled this matter in May 2006

On or about January 12, 2006, James Paul Brown, a former consultant to the Company filed a complaint against the Company in the Superior Court of the State of California. The Complaint alleges a breach of contract. Subsequent to the date of the financial statements, the Company and the Plaintiff settled the dispute and the Company has recorded the settlement amount as of March 31, 2006.

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In January 2006, a former employee of the Company filed a complaint alleging wrongful termination against the Company. The former employee is seeking \$230,000 in damages. The Company believes that it has meritorious defenses to the plaintiff's claims and intends to vigorously defend itself against the Plaintiff's claims. Management believes the ultimate outcome of this matter will not have a material adverse effect on the Company's consolidated financial position or results of operations.

On or about April 4, 2006, the Company filed a complaint against Paul Reep, Adrian Butash, John Barnett, Chanty Cheang, Jaime Cardona (former Company employees and officers), and Angela Wiggins ( a former consultant to the Company) in the United States District Court for the Central District of California . The Company has asked the court to make a judicial determination that an agreement, which the Company did not authorize and which is the basis of previously disclosed litigation against the Company by Paul Reep, a former employee of the Company, and a new action filed by former employees of the Company as set forth in the subsequent paragraph, is invalid and unenforceable. This matter is in its early stages.

On or about April 17, 2006, former employees of the Company filed a complaint against the Company and certain of its current officers and Directors in Los Angeles County Superior Court. The Complaint alleges a breach of contract, violations of California Labor Code and wrongful termination and is seeking \$950,000 in specified damages, plus fees and costs. The complaint alleges a breach of contract.

The Company is subject to other legal proceedings and claims, which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, the Company believes that the final disposition of such matters should not have a material adverse effect on its financial position, results of operations or liquidity.

### Registration of Company's Shares of Common Stock

Until the Company successfully completes its pending registration statement on SEC Form SB-2, the Company is subject to liquidated damages (see Notes D and F). In connection with the \$ 7,371,000 million convertible debt financing in the quarter ended March 30, 2005, the Company was obligated to complete a stock registration by June 2005. Since the registration was not effective by June 2005, the Company has been accruing and charging to operations the stipulated liquidated damages in shares of Company stock accruing at the rate of 3.5% per month on the face value of the previously issued convertible notes. For the period ended March 31, 2006, the Company has charged \$773,995 to operations representing the penalties and has included this amount in accounts

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payable and accrued expenses.

### Matters Voluntarily Reported to the SEC and Securities Act Violations

We previously disclosed that we were investigating the circumstances surrounding certain issuances of shares to employees and consultants in 2005, and have engaged our new outside counsel to conduct this investigation. We have voluntarily reported our current findings from the investigation to the SEC, and we have agreed to provide the SEC with further information arising from the investigation. We believe that the issuance of 8,000,000 shares to employees in July 2005 was effectuated by both our former President and our former Chief Financial Officer/Chief Operating Officer without approval of the board of directors. These former officers received a total of 3,000,000 of these shares. In addition, it appears that the 8,000,000 shares issued in July 2005, as well as an additional 550,000 shares issued to employees and consultants in March, May and August 2005, were improperly issued without a restrictive legend stating that the shares could not be resold legally except in compliance with the Securities Act of 1933, as amended. Our investigation is continuing. The members of our management who effectuated the stock issuances that are being examined in the investigation no longer work for us. We believe that we may incur significant costs and expenses in continuing this investigation.

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In the event that any of the exemptions from registration with respect to the issuance of the Company's common stock under federal and applicable state securities laws were not available, the Company may be subject to claims by federal and state regulators for any such violations. In addition, if any purchaser of the Company's common stock were to prevail in a suit resulting from a violation of federal or applicable state securities laws, the Company could be liable to return the amount paid for such securities with interest thereon, less the amount of any income received thereon, upon tender of such securities, or for damages if the purchaser no longer owns the securities. As of the date of these financial statements, the Company is not aware of any alleged specific violation or the likelihood of any claim. There can be no assurance that litigation asserting such claims will not be initiated, or that the Company would prevail in any such litigation.

The Company is unable to predict the extent of its ultimate liability with respect to any and all future securities matters. The costs and other effects of any future litigation, government investigations, legal and administrative cases and proceedings, settlements, judgments and investigations, claims and changes in this matter could have a material adverse effect on the Company's financial condition and operating results

### NOTE I - RESTATEMENT

The accompanying financial statements as of March 31, 2005 and for the three and six month period ended March 31, 2005 have been restated to present the effects of revaluing the Company's warrants.

The result of the restatement is to reflect gain on warrant revaluation of \$13,310,729 and \$10,174,403 for the and to increase the interest expense related to warrant financing costs for the three and six month periods ended March 31, 2005 by \$ 11,932,175 and \$ 14,312,214. Net income (loss) for the three and six month periods ended March 31, 2005 increased by \$ 13,554 and \$ (5,502,811). The Company has also increased Selling, General and Administrative expense by \$1,365,000 compared to the previous March 31, 2005 10-QSB for compensation expenses. The changes in reported amounts are summarized as follows:

Following is a reconciliation of the Company's restatement of the

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Condensed Consolidated Statement of Operations for the periods ended March 31, 2005.

	Three Months Ended March 31, 2005 (As Restated)	(As Reported)	Six Months Ended March 31, 2005 (As Restated)	(As Reported)
	-----	-----	-----	-----
Operating expenses:				
Selling, general and administrative	\$ 10,406,288	\$9,041,288	\$ 21,199,209	
Research and development	-	-	-	
Depreciation and amortization	7,306	7,306	12,027	
	-----	-----	-----	
Total operating expenses	10,413,594	9,048,594	21,211,236	
Operating loss	(10,413,594)	(9,048,594)	(21,211,236)	
Net gain/(loss) on revaluation of warrant liability	13,310,729	-	10,174,403	
Other income (expense)	3,100	3,100	3,415	
Interest income (expense)	(19,567,738)	(7,635,563)	(23,515,586)	
	-----	-----	-----	
Net Income (Loss)	(16,667,503)	(16,681,057)	(34,549,004)	
Gain (Loss) per common share (basic and assuming dilution)	\$ (0.31)	\$ (0.31)	\$ (0.86)	
Weighted average shares outstanding	53,044,883	53,044,883	40,082,628	

### NOTE J - SUBSEQUENT EVENTS

On April 13, 2006, the Company borrowed \$100,000, at a rate of 7.5% per annum, from BioCogent, Ltd., ("BioCogent") whose President and Chief Executive Officer and sole stockholder is James A. Hayward, one of the Company's directors and its Chief Executive Officer ("Dr. Hayward"). This loan is due and payable upon the earlier to occur of (1) the close of business on June 30, 2006, or (2) the closing of the issuance and sale by the Company of its securities for gross proceeds of at least \$250,000 (see Note C).

In May, 2006 the Company signed a Business Development and Trademark License Agreement with Dr. Suwelack Skin & Health Care AG ("Dr. Suwelack") providing Dr. Suwelack rights to use the Company's SigNature(TM) logo, which is printed with ink containing the Company's proprietary encrypted botanical DNA technology, and to participate in the Company's SigNature(TM) Program. The terms of this one year license agreement provide Suwelack with a limited, non-exclusive, non-transferable right to use the SigNature(TM) logo on its packaging and labels. Dr. Suwelack will pay us a one time license fee in the amount of EUR15,000 in consideration for the use of the Company's SigNature(TM) logo. EUR7,500 of the license fee was due upon signing of the agreement and the remaining 50% is due upon receipt of the shipped labels. Dr. Hayward serves on Dr. Suwelack's board of directors. BioCogent, whose President and Chief Executive Officer and sole stockholder is Dr. Hayward, provides consulting services to Dr. Suwelack. Dr. Suwelack and BioCogent recently reached an agreement in principle, with respect to which no written agreement has been executed, by which BioCogent will continue to provide consulting services to Dr. Suwelack and Dr. Hayward will serve as Dr. Suwelack's president on a part-time basis reporting to Dr. Suwelack's Chief Executive Officer.



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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto, included elsewhere within this report. The quarterly report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements using terminology such as "can", "may", "believe", "designated to", "will", "expect", "plan", "anticipate", "estimate", "potential" or "continue", or the negative thereof or other comparable terminology regarding beliefs, plans, expectations or intentions regarding the future. You should read statements that contain these words carefully because they:

- o discuss our future expectations;
- o contain projections of our future results of operations or of our financial condition; and
- o state other "forward-looking" information.

We believe it is important to communicate our expectations. However, forward looking statements involve risks and uncertainties and our actual results and the timing of certain events could differ materially from those discussed in forward-looking statements as a result of certain factors, including those set forth under "Risk Factors," "Business" and elsewhere in this prospectus. All forward-looking statements and risk factors included in this document are made as of the date hereof, based on information available to us as of the date thereof, and we assume no obligations to update any forward-looking statement or risk factor, unless we are required to do so by law.

PLAN OF OPERATIONS

Sales and Marketing

We believe our revenues will come from three sources:

- o direct sales to manufacturers, distributors, and/or retailers;
- o sales through our OEM relationships; and
- o authentication (laboratory) services.

We employ a multi-tier sales and marketing strategy involving our marketing and sales staff working together with high-level contacts in target industries and our OEM base. We are attempting to develop strategic alliances and marketing partners by setting up alliances with Biowell Technology, Inc.'s ("Biowell") technology partners, granting licenses to existing anti-counterfeit suppliers and partner with industry leaders for intellectual property development.

We are cognizant that no technology exists today to enable someone in the street to ascertain, at the point of purchase, whether an expensive product, or a child's foodstuff, or pharmaceutical product is genuine, worth the money being paid and safe to use or ingest. No brand owner is able to rapidly determine whether a product is real or fake. Many multi-billion dollar brands have no technology to protect against counterfeiting, to detect its occurrence

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and to interdict or prosecute the counterfeiter. No company has the capability to determine with forensic certainty that it is subject to attack. Such companies remain seriously exposed to product liability, loss of consumer confidence and loss of revenues. Governments have no rapid detection system to determine at the point of entry, inspection or seizure whether products are real or fake. A major thrust of our marketing efforts is to work with consumer groups, media, corporate officers, government departments, customs, insurers and others to bring home the message that, in a world of criminality and terrorism, no-one is safe.

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### Business Strategy and Approach

We have established integrated business operations addressing and servicing the needs of the global security marketplace on the part of corporations and governments for; anti-counterfeiting, fraud prevention, product authentication, brand protection, supply chain management and protection.

### Intellectual Property Development, Product Operations & Partnerships

We have proprietary DNA security technology, and develop security solutions that protect corporate and intellectual property from counterfeiting, fraud, piracy and product diversion using botanical DNA as an encrypted/code molecule that can be embedded in inks, paper, substrates, liquids, textiles, thread, plastics, holograms and microchips.

We produce security solutions customized to our customer's needs. We market and sell DNA anti-counterfeit and fraud prevention solutions that integrate into, and layer with, existing security solutions. These DNA security features are integrated at the original equipment manufacturer level with ink, paper, liquids, thread and hologram producers, who in turn sell/supply finished security products such as primary and secondary product packaging for pharmaceuticals, beauty products, textiles, currency, passports, ID cards, etc. We have strict protocols for specifying, integrating, testing, shipping and confirming the presence of DNA in any given product.

We plan to develop new product lines that will address specific new challenges in the security marketplace, and bring these advances to target industries, customers and countries.

Additionally, we will identify strategic partnerships and co-marketing ventures, and licensees to work with us to develop, market and sell our biotechnological security products. This will include sub-licensing the technology to key partners in specific sectors with an established base of customers. These partners will be able to enhance their product lines and client services by adding our technology to the existing security matrix in their products, providing an enhanced solution to deter fraud and counterfeiting.

### Management Strategy

We anticipate a period of rapid change as we begin commercialization of the products now available subsequent signing of our licenses with Biowell, (b) the establishment of our prototyping labs at the State University of New York at Stony Brook ("Stony Brook University"), and (c) the availability of products that have recently been commercialized in Asia by Biowell.

We have organized our resources to manage our commercialization effectively, optimizing the delivery of new prototypes for customers, and managing outsourcing especially through our OEMs. Our Chief Executive Officer is responsible for the strategic direction, coordinating with our overseas

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technology partner Biowell, scientific development, operations and corporate governance, business development and sales, including relations with US and foreign government agencies, developing business relationships with target corporations and OEM's, and securing revenues. Our Controller and acting Chief Financial Officer cover overall financial management, financial reporting, corporate administration and investors relations. Our marketing department develops strategic awareness of our technologies across target industry sectors, their associated media and lobbying companies and liaises with regulatory bodies (EPA, FDA, etc) and industry associations (CTFA, PHARMA, etc). Our Chairman oversees the operations of Biowell, including the development of all Asian territorial sales that are subject to royalty payments due to us. Both our Chairman and our Strategic Technology Development Officer manage the development of core DNA sciences for current and future applications. Our Strategic Technology Development Officer is principally engaged in the productization of DNA markers for specific industry applications, and for liaison with corresponding scientists from our principal OEM partners, e.g., petroleum markers, chemical markers, markers for precious stones, DNA-encrypted inks, DNA markers for the pharmaceutical industry, etc.

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### Consultant & Enforcement Operations

As nations are threatened by terrorism and corporations try to prevent corporate fraud, counterfeiting, product diversion and industrial espionage, the need for secure anti-counterfeiting and identification systems increases. Our technology can provide important and cost-effective support for local, state, and federal governments as well as corporations doing business with highly sensitive information or products susceptible to counterfeit. Our anti-counterfeiting technology can be used for the following types of identification and important government documents:

- o Passports
- o Green cards
- o Visas
- o Driver's licenses
- o Social Security cards
- o Student visas
- o Military ID's
- o Other important Identity cards and official documents

We intend to work in collaboration with Biowell and other security organizations in order to continue to research and develop new product lines derived from, but not limited to, DNA technology. Research and development of new product lines is an ongoing commitment and is currently underway in the Biowell labs and will continue in the U.S. at our new facilities established at the Long Island High Technology Incubator (LIHTI) at Stony Brook University. Research and development objectives include the development of a new line of detection technologies that will provide faster and more convenient ways to authenticate DNA, continuous effort to incorporate our DNA markers with various products for new applications, and establishment of a leading DNA authentication service lab. We believe that we will obtain commercial revenues for these efforts within 12-24 months, although no assurances can be given that we will ever generate revenues. Our prototyping laboratory will customize

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"off-the-shelf" products for new customers on a case-by-case basis. These new products are typically newly configured labels, inks or packing elements. We have identified several options for remote detection and faster detection methodologies.

We will consult with our clients on a total security service offering; how to protect their brands, intellectual property, products and physical security access and how to reduce risk exposure, product liability exposure and product recall liabilities. We plan to offer worldwide DNA analysis services supporting the authentication of products and the detection, interdiction, deterrence and prosecution of counterfeiters and related crimes, through our subcontractors, sub-licensees and security industry collaborative partners.

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### International Sub-License Operations

Developing Technology - We have an in-depth understanding of DNA microchip design and applications. We will jointly develop DNA-holograms and DNA-Hologram-RFID devices, DNA-inks, DNA-dyes and DNA-security labels with leading original equipment manufacturers in these specialist fields.

We will utilize our existing relationships and develop new ones to introduce our anti-counterfeiting technology to generate business. Each industry has unique requirements and needs for their anti-counterfeit solutions, and we believe our DNA technology will provide maximum security technologies. For example, our smart packaging solutions with DNA security markers in ink, paper and holograms has widespread application in packaging for pharmaceuticals, cosmetics, automotive markets, passports, ID's and currency. Our proprietary technology offers immediate and affordable detection and security for their brands and products.

Strong Technology Alliances - Our technology can also provide advanced security dimensions to:

- o Electronics security: access and physical/plant security (biometric security cards enhanced with DNA)
- o Security Holograms (DNA enhanced)
- o Security papers and printing
- o Holograms (DNA holograms)
- o Other security-related products and systems

Law Enforcement Expertise - The resources of our collaborative partners in the security industry include former federal law enforcement, security, and intelligence officers who provide us with extensive contacts and hands-on experience in:

- o Intellectual property investigation
- o Counter-intelligence
- o Personal security services
- o Anti-counterfeit technologies
- o Secure communications and data management

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### Critical Accounting Policies

Financial Reporting Release No. 60, published by the SEC, recommends that all companies include a discussion of critical accounting policies used in the preparation of their financial statements. While all these significant accounting policies impact our financial condition and results of operations, we view certain of these policies as critical. Policies determined to be critical are those policies that have the most significant impact on our consolidated financial statements and require management to use a greater degree of judgment and estimates. Actual results may differ from those estimates.

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We believe that given current facts and circumstances, it is unlikely that applying any other reasonable judgments or estimate methodologies would cause a material effect on our consolidated results of operations, financial position or liquidity for the periods presented in this report.

The accounting policies identified as critical are as follows:

- o Equity issued with registration rights
- o Warrant liability
- o Fair value of intangible assets

#### Equity Issued with Registration Rights

In connection with placement of our convertible notes and warrants to certain investors during the fiscal quarter ended March 31, 2005, we granted certain registration rights that provide for liquidated damages in the event of failure to timely perform under the agreements. Although these notes and warrants do not provide for net-cash settlement, the existence of liquidated damages provides for a defacto net-cash settlement option. Therefore, the common stock underlying the notes and warrants subject to such liquidated damages does not meet the tests required for shareholders' equity classification, and accordingly has been reflected between liabilities and equity in the accompanying consolidated balance sheet until such time as the conditions are eliminated.

#### Warrant Liability

In connection with the placement of certain debt instruments during the fiscal quarter ended March 31, 2005, as described above, we issued freestanding warrants. Although the terms of the warrants do not provide for net-cash settlement, in certain circumstances, physical or net-share settlement is deemed to not be within our control and, accordingly, we are required to account for these freestanding warrants as a derivative financial instrument liability, rather than as shareholders' equity.

The warrant liability is initially measured and recorded at its fair value, and is then re-valued at each reporting date, with changes in the fair value reported as non-cash charges or credits to earnings. For warrant-based derivative financial instruments, the Black-Scholes option pricing model is used to value the warrant liability.

The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is re-assessed at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12

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months of the balance sheet date.

We do not use derivative instruments to hedge exposures to cash flow, market, or foreign currency risks.

### Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenue and expenses during the reporting period. The most significant estimates relate to the estimation of percentage of completion on uncompleted contracts, valuation of inventory, allowance for doubtful accounts and estimated life of customer lists. Actual results could differ from those estimates.

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### Fair Value of Intangible Assets

We have adopted SFAS No. 142, Goodwill and Other Intangible Assets, whereby we periodically test our intangible assets for impairment. On an annual basis, and when there is reason to suspect that their values have been diminished or impaired, these assets are tested for impairment, and write-downs will be included in results from operations.

On July 12, 2005, we acquired certain intellectual properties from Biowell through an Asset Purchase Agreement in exchange for 36 million shares of our restricted common stock having an aggregate fair value at the date of issuance of \$24.12 million. The value of the acquired intangible assets was \$9,430,900, with the balance of the purchase price, or \$14,689,100, charged to operations as a cost of the transaction.

### Revenues

Since our inception on September 16, 2002, we have not generated material revenues from operations. We believe we will begin generating revenues from operations in the fiscal year as we transition from a development stage enterprise to that of an active growth stage company, although no assurances can be given that we will generate any revenues from operations.

### Costs and Expenses

#### Selling, General and Administrative

Selling, general and administrative expenses for the six month period ended March 31, 2006 compared to same period in 2005 decreased \$18.110 million or 85% to \$3.089 million from \$21.199 million in the prior period due to non-recurring financing and related costs incurred during the March 2005 quarter.

#### Research and Development

Research and development expenses increased \$91,303 for the six month period ended March 31, 2006 compared to the same period in 2005 from \$0 to \$91,303 primarily due to startup of collaboration with The Center for Biotechnology at Stony Brook University.

#### Depreciation and Amortization

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In the six month period ended March 31, 2006, depreciation and amortization increased \$672,000 for the period compared to the same period in 2005 from \$12,000 to \$684,000. In the year ended September 30, 2005, we capitalized \$9.431 million related to an intellectual property asset acquisition. As a result, we recorded amortization expense totaling \$677,040 for the six month period ended March 31, 2006 compared to no intangible asset amortization in the three months ended March 31, 2005. We estimate a seven year useful life that commenced during the fourth fiscal quarter of 2005.

### Total Operating Expenses

Total operating expenses during the six months ended March 31, 2006 decreased to \$3.864 million from \$21.211 million, or a decrease of \$17.347 million as a result of the combination of factors listed above.

### Gain

Gain on revaluation of warrant liability increased by \$2.800 million to \$12.974 million from \$10.174 million for the six month periods ended March 31, 2006 and 2005, respectively.

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### Interest Expenses

Interest expense, for the six month period ended March 31, 2006 decreased to \$79,000 from \$23.516 million in the same period of 2005, a decrease of \$23.437 million primarily resulting from the reduction in financing in 2006 as compared to 2005.

### Net Income

Net Income for the six month period ended March 31, 2006 increased to \$9.040 million from a loss of \$34.549 million in the prior period as a result of the combination of factors described above.

### Liquidity and Capital Resources

Our liquidity needs originate from working capital requirements, indebtedness payments and research and development expenditure funding. Historically, we have financed our operations through the sale of equity and convertible debt as well as borrowings from various credit sources.

In the six month period ended March 31, 2006, we completed two additional private placements of debt and associated warrants. In November, 2005, we issued and sold a promissory note in principal amount of \$550,000. We issued warrants to purchase a total of 5,500,000 shares of our common stock at an exercise price of \$0.50 per share to certain persons designated by International Allied Fund, and paid \$55,000 in cash to VC Arjent for its services as the placement agent for this placement. All principal and accrued but unpaid interest under this note was paid in full shortly after the closing of and from the proceeds of the March 8, 2006 offering. On March 8, 2006, we issued and sold an aggregate of 30 units consisting of (i) a \$50,000 principal amount secured convertible promissory note bearing interest at 10% per annum and convertible at \$0.50 per share, and (ii) a warrant to purchase 100,000 shares of our common stock at an exercise price of \$0.50 per share, for aggregate gross proceeds of \$1.5 million. The units were sold pursuant to subscription agreements by and between each of the purchasers and Applied DNA Operations Management, Inc., a Nevada corporation and our wholly owned subsidiary (our "Subsidiary"). The \$2.050 million in gross proceeds from these offerings were held by our Subsidiary for our benefit and used to fund commissions, fees and

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expenses associated with the placements, to repay the outstanding promissory note described above plus accrued interest thereunder, to fund financing fees, consultants and public reporting costs, salaries and wages, research and development, facility costs as well as and general working capital needs.

On March 24, 2006, we commenced an offering (the "Offshore Offering") of up to 140 units, at a price of \$50,000 per unit, for a maximum offering of \$7 million for sale to "accredited investors" who are not "U.S. persons." The units being sold as part of the Offshore Offering consist of (i) a \$50,000 principal amount secured convertible promissory note, and (ii) a warrant to purchase 100,000 shares of our common stock at a price of \$0.50 per share. On May 2, 2006, we closed on the first tranche of the Offshore Offering in which we sold 20 units for aggregate gross proceeds of \$1,000,000. We incurred \$375,000 in commissions, fees and expenses which was paid at closing.

On March 29, 2006 and April 13, 2006, we borrowed \$200,000 in the aggregate, at a rate of 7.5% per annum, from BioCogent, Ltd., a New York corporation ("BioCogent") whose President and Chief Executive Officer and sole stockholder is James A. Hayward, one of our directors and our Chief Executive Officer. These loans are due and payable upon the earlier to occur of (1) the close of business on June 30, 2006, or (2) the closing of the issuance and sale of our securities for gross proceeds of at least \$250,000. The proceeds from the loans will be used for general corporate purposes. The note issued on March 29, 2006 was repaid with interest in May, 2006.

Substantially all of the real property used in our business is leased under operating lease agreements.

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As of March 31, 2006, we had a working capital deficit of \$2,706,482 as a result of our operating losses from our inception through March 31, 2006. We generated a cash flow deficit of \$14,197,587 from operating activities from our inception on September 16, 2002 through March 31, 2006. Cash flows used in investing activities was \$97,682 during this period. We met our cash requirements during this period through the receipt of \$14,372,984 in the form of private placement of our common stock, the issuance of convertible notes (net of repayments and costs), and advances from the Company's officers, principal shareholders and third parties.

As of March 31, 2006, we had \$2,010,429 in outstanding notes payables. Please see Note C in our unaudited financial statements included in this Form 10-QSB for the terms of such notes payable.

We expect capital expenditures to be less than \$500,000 fiscal 2006. Our primary investments will be in laboratory equipment to support prototyping and our authentication services.

While we have raised capital to meet our working capital needs in the past, and will require additional financing within the next 12 months in order to meet our current and projected cash flow deficits from operations and development. We have sufficient funds to conduct our operations for several months, but not for 12 months or longer. Financing transactions may include the issuance of equity or debt securities, obtaining credit facilities, or other financing mechanisms. However, the trading price of our common stock, a downturn in the U.S. or global stock and debt markets and other reasons could make it more difficult to obtain financing through the issuance of equity securities or borrowing. Further, if we issue additional equity or convertible debt securities, stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of our common stock. If additional financing is not available



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or is not available on acceptable terms, this could have a material adverse effect on our business, results of operations liquidity and financial condition.

Our registered independent certified public accountants have stated in their report dated October 21, 2005, that we have incurred operating losses in the last two years, and that we are dependent upon management's ability to develop profitable operations. These factors among others may raise substantial doubt about our ability to continue as a going concern.

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In connection with the January and February 2005 Placement, we granted the investors registration rights. Pursuant to the registration rights agreement, if we did not file the registration statement by February 15, 2005, or if we did not have the registration statement declared effective on or before June 15, 2005, we are obligated to pay liquidated damages in the amount of 3.5% per month of the face amount of the notes, which equals \$257,985, until the registration statement is declared effective. At our option, these liquidated damages can be paid in cash or restricted shares of our common stock. All of the liquidated damages that we paid were paid in common stock, although any future payments of liquidated damages may, at our option, be made in cash. If we decide to pay the liquidated damages in cash, we would be required to use our limited working capital and potentially raise additional funds. If we decide to pay the liquidated damages in shares of common stock, the number of shares issued would depend on our stock price at the time that payment is due. Based on the closing market prices of \$0.66, \$0.58, \$0.70, \$0.49, \$0.32 and \$0.20 for our common stock on July 15, 2005, August 15, 2005, September 15, 2005, October 17, 2005, November 15, 2005 and December 15, 2005, respectively, we issued a total of 3,807,375 shares of common stock in liquidated damages from August, 2005 to January, 2006. The issuance of shares upon payment of liquidated damages will have the effect of further diluting the proportionate equity interest and voting power of holders of our common stock, including investors in this offering. Liquidated damages in the form of common stock were paid for the period from June 15, 2005 to December 15, 2005. We believe that we have no enforceable obligation to pay further liquidated damages since the shares we agreed to register for resale are eligible for resale under Rule 144 of the Securities Act of 1933, as amended, and such continuing liquidated damages are grossly inconsistent with actual damages to the purchasers of the notes and warrants. However, we are seeking to confirm this position by obtaining the waiver and release of the holders of these securities of further liquidated damages. If these persons do not waive and release and successfully bring a claim against us with respect to such liquidated damages, it could result in a significant decrease in our liquidity or assets, which could result in the reduction or termination of our business. As of March 31, 2006 we have accrued \$773,995 in penalties representing the further liquidated damages associated with our failure to file the registration statement by the deadline and have included this amount in accounts payable and accrued expenses.

### Matters Voluntarily Reported to the SEC and Securities Act Violations

We previously disclosed that we were investigating the circumstances surrounding certain issuances of shares to employees and consultants in 2005, and have engaged our new outside counsel to conduct this investigation. We have voluntarily reported our current findings from the investigation to the SEC, and we have agreed to provide the SEC with further information arising from the investigation. We believe that the issuance of 8,000,000 shares to employees in July 2005 was effectuated by both our former President and our former Chief Financial Officer/Chief Operating Officer without approval of the board of directors. These former officers received a total of 3,000,000 of these shares. In addition, it appears that the 8,000,000 shares issued in July 2005, as well as an additional 550,000 shares issued to employees and consultants in March,

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May and August 2005, were improperly issued without a restrictive legend stating that the shares could not be resold legally except in compliance with the Securities Act of 1933, as amended. Our investigation is continuing. The members of our management who effectuated the stock issuances that are being examined in the investigation no longer work for us. We believe that we may incur significant costs and expenses in continuing this investigation.

In the event that any of the exemptions from registration with respect to the issuance of our common stock under federal and applicable state securities laws were not available, we may be subject to claims by federal and state regulators for any such violations. In addition, if any purchaser of our common stock were to prevail in a suit resulting from a violation of federal or applicable state securities laws, we could be liable to return the amount paid for such securities with interest thereon, less the amount of any income received thereon, upon tender of such securities, or for damages if the purchaser no longer owns the securities. As of the date of these financial statements, we are not aware of any alleged specific violation or the likelihood of any claim. There can be no assurance that litigation asserting such claims will not be initiated, or that we would prevail in any such litigation.

### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

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### Product Research and Development

As a result of the recent financings, we anticipate expending \$500,000 of available cash towards research and development activities during the next twelve (12) months.

### Acquisition of Plant and Equipment and Other Assets

We do not anticipate the sale of any material property, plant or equipment during the next 12 months. We do not anticipate the acquisition of any material property, plant or equipment during the next 12 months.

### Number of Employees

From our inception through the period ended March 31, 2006, we have mainly relied on the services of outside consultants for services. We currently have five employees. In order for us to attract and retain quality personnel, we anticipate we will have to offer competitive salaries to future employees. We anticipate that it may become desirable to add additional full and or part time employees to discharge certain critical functions during the next 12 months. This projected increase in personnel is dependent upon our ability to generate revenues and obtain sources of financing. There is no guarantee that we will be successful in raising the funds required or generating revenues sufficient to fund the projected increase in the number of employees. As we continue to expand, we will incur additional cost for personnel.

### Going Concern

The financial statements included in this filing have been prepared in conformity with generally accepted accounting principles that contemplate the our continuance of as a going concern. Our cash position may be inadequate to pay all of the costs associated with testing, production and marketing of products. Management intends to use borrowings and security sales to mitigate the effects of its cash position, however no assurance can be given that debt or equity financing, if and when required will be available. The financial

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statements do not include any adjustments relating to the recoverability and classification of recorded assets and classification of liabilities that might be necessary should we be unable to continue existence.

### Trends, Risks and Uncertainties

We have sought to identify what we believe to be the most significant risks to our business, but we cannot predict whether, or to what extent, any of such risks may be realized nor can we guarantee that we have identified all possible risks that might arise. Investors should carefully consider all of such risk factors before making an investment decision with respect to our common stock.

### RISK FACTORS

Much of the information included in this quarterly report includes or is based upon estimates, projections or other "forward-looking statements". Such forward-looking statements include any projections or estimates made by us and our management in connection with our business operations. While these forward-looking statements, and any assumptions upon which they are based, are made in good faith and reflect our current judgment regarding the direction of our business, actual results will almost always vary, sometimes materially, from any estimates, predictions, projections, assumptions or other future performance suggested herein.

Such estimates, projections or other "forward-looking statements" involve various risks and uncertainties as outlined below. We caution the reader that important factors in some cases have affected and, in the future, could materially affect actual results and cause actual results to differ materially from the results expressed in any such estimates, projections or other "forward-looking statements".

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Our common shares are considered speculative. Prospective investors should consider carefully the risk factors set out below.

### RISKS RELATING TO OUR BUSINESS

We Have a History Of Losses Which May Continue, Which May Negatively Impact Our Ability to Achieve Our Business Objectives.

For the six month period ended March 31, 2006, we produced a net income of \$8,269,828 with \$12.974 million attributable to the revised classification and for the three month period ended March 31, 2006, we incurred a net income of \$2,586,624. We cannot assure you that we can achieve or sustain profitability on a quarterly or annual basis in the future. Our operations are subject to the risks and competition inherent in the establishment of a business enterprise. There can be no assurance that future operations will be profitable. Our revenues and profits, if any, will depend upon various factors, including whether we will be able to generate revenue. As a result we continue to incur losses, our accumulated deficit will continue to increase, which might make it harder for us to obtain financing in the future. We may not achieve our business objectives and the failure to achieve such goals would have an adverse impact on us, which could result in reducing or terminating our operations.

If We Are Unable to Obtain Additional Funding Our Business Operations Will be Harmed and If We Do Obtain Additional Financing Our Then Existing Shareholders May Suffer Substantial Dilution.

We will require additional funds to sustain and expand our research and

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development activities. We anticipate that we will require up to approximately \$500,000 to fund our anticipated research and development operations for the next twelve months, depending on revenue from operations. Additional capital will be required to effectively support the operations and to otherwise implement our overall business strategy. Even if we do receive additional financing, it may not be sufficient to sustain or expand our research and development operations or continue our business operations.

There can be no assurance that financing will be available in amounts or on terms acceptable to us, if at all. The inability to obtain additional capital will restrict our ability to grow and may reduce our ability to continue to conduct business operations. If we are unable to obtain additional financing, we will likely be required to curtail our research and development plans. Any additional equity financing may involve substantial dilution to our then existing shareholders.

Our Independent Auditors Have Expressed Substantial Doubt About Our Ability to Continue As a Going Concern, Which May Hinder Our Ability to Obtain Future Financing.

In their report dated October 21, 2005, our independent auditors stated that our financial statements for the year ended from September 30, 2005 were prepared assuming that we would continue as a going concern. Our ability to continue as a going concern is an issue raised due to our incurring net losses of \$52,847,993 during the period September 16, 2002 (date of inception) to March 31, 2006. We continue to experience net operating losses. Our ability to continue as a going concern is subject to our ability to generate a profit and/or obtain necessary funding from outside sources, including obtaining additional funding from the sale of our securities, generating sales or obtaining loans and grants from various financial institutions where possible. Our continued net operating losses increase the difficulty in meeting such goals and there can be no assurances that such methods will prove successful.

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Our Research and Development Efforts for New Products May be Unsuccessful.

We will incur significant research and development expenses to develop new products and technologies. There can be no assurance that any of these products or technologies will be successfully developed or that if developed they will be commercially successful. In the event that we are unable to develop commercialized products from our research and development efforts or we are unable or unwilling to allocate amounts beyond our currently anticipated research and development investment, we could lose our entire investment in these new products and this may materially and adversely affect our business operations, which would result in loss of revenues and greater operating expenses.

Our Acquired Technology Has Yet to be Independently Validated

In July 2005, we acquired certain intellectual property. Such intellectual property relating to the botanical DNA, encapsulation methods, integrity of the technology and all other stated claims by the seller need to be independently validated by a third party. Satisfactory completion of this independent validation will be required prior to their being available for commercial sale. In the event that some or all of the technology cannot be independently validated, we will be unable to commercially develop products utilizing such technology, which could have a materially adverse effect on our business and results of operations.

Failure to License New Technologies Could Impair Our New Product Development.

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To generate broad product lines, it is advantageous to sometimes license technologies from third parties rather than depend exclusively on our own employees. As a result, we believe our ability to license new technologies from third parties is and will continue to be important to our ability to offer new products.

In addition, from time to time we are notified or become aware of patents held by third parties that are related to technologies we are selling or may sell in the future. After a review of these patents, we may decide to seek a license for these technologies from these third parties or discontinue our products. There can be no assurance that we will be able to continue to successfully identify new technologies developed by others. Even if we are able to identify new technologies of interest, we may not be able to negotiate a license on favorable terms, or at all. If we lose the rights to patented technology, we may need to discontinue selling certain products or redesign our products, and we may lose a competitive advantage. Potential competitors could license technologies that we fail to license and potentially erode our market share for certain products. Our licenses typically subject us to various commercializations, sublicensing, minimum payment, and other obligations. If we fail to comply with these requirements, we could lose important rights under a license. In addition, certain rights granted under the license could be lost for reasons beyond our control. We may not receive significant indemnification from a licensor against third party claims of intellectual property infringement.

We Currently Have Limited Manufacturing, Sales, Marketing or Distribution Capabilities.

We currently have limited in-house manufacturing capability. We rely on Biowell and third-party vendors for this service. We do not currently have any arrangements with any distributors and we may not be able to enter into arrangements with qualified distributors on acceptable terms or at all. We currently have a limited sales and marketing team. If we are not able to develop greater sales, marketing or distribution capacity, we may not be able to generate revenue or sufficient revenue to support our operations.

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If We Fail to Introduce New Products, or Our Existing Products are not Accepted by Potential Customers, We May Not Gain or May Lose Market Share.

Rapid technological changes and frequent new product introductions are typical for the markets we serve. Our future success will depend in part on continuous, timely development and introduction of new products that address evolving market requirements. We believe successful new product introductions provide a significant competitive advantage because customers invest their time in selecting and learning to use new products, and are often reluctant to switch products. To the extent we fail to introduce new and innovative products, we may lose market share to our competitors, which will be difficult or impossible to regain. Any inability, for technological or other reasons, to successfully develop and introduce new products could reduce our growth rate or damage our business.

We may experience delays in the development and introduction of products. We cannot assure that we will keep pace with the rapid rate of change in life sciences research or that our new products will adequately meet the requirements of the marketplace or achieve market acceptance. Some of the factors affecting market acceptance of new products include:

- o availability, quality and price relative to competitive products;

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- o the timing of introduction of the product relative to competitive products;
- o customers' opinions of the products' utility;
- o ease of use;
- o consistency with prior practices;
- o scientists' opinions of the products' usefulness;
- o citation of the product in published research; and
- o general trends in life sciences research.

We have not experienced any difficulties with the preceding factors, however, there can be no assurance that we will not experience difficulties in the future. The expenses or losses associated with unsuccessful product development or lack of market acceptance of our new products could materially adversely affect our business, operating results and financial condition.

### A Manufacturer's Inability to Produce Our Goods on Time and to Our Specifications Could Result in Lost Revenue and Net Losses

We do not own or operate any manufacturing facilities and therefore depend upon independent third parties for the manufacture of all of our products. Our products are manufactured to our specifications. The inability of a manufacturer to ship orders of our products in a timely manner or to meet our quality standards could cause us to miss the delivery date requirements of our customers for those items, which could result in cancellation of orders, refusal to accept deliveries or a reduction in purchase prices, any of which could have a material adverse effect as our revenues would decrease and we would incur net losses as a result of sales of the product, if any sales could be made. Because of our business, the dates on which customers need and require shipments of our security products from us are critical.

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### If We Need to Replace Manufacturers, Our Expenses Could Increase Resulting in Smaller Profit Margins

We compete with other companies for the production capacity of our manufacturers and import quota capacity. Some of these competitors have greater financial and other resources than we have, and thus may have an advantage in the competition for production and import quota capacity. If we experience a significant increase in demand, or if an existing manufacturer of ours must be replaced, we may have to expand our third-party manufacturing capacity. We cannot assure you that this additional capacity will be available when required on terms that are acceptable to us or similar to existing terms which we have with our manufacturers, either from a production standpoint or a financial standpoint. We do not have long-term contracts with any manufacturer. None of the manufacturers we use produces our products exclusively.

Should we be forced to replace one or more of our manufacturers, we may experience an adverse financial impact, or an adverse operational impact, such as being forced to pay increased costs for such replacement manufacturing or delays upon distribution and delivery of our products to our customers, which could cause us to lose customers or lose revenues because of late shipments.

### If a Manufacturer of Ours Fails to Use Acceptable Labor Practices, We Might Have

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Delays in Shipments or Face Joint Liability for Violations, Resulting in Decreased Revenue and Increased Expenses

While we require our independent manufacturers to operate in compliance with applicable laws and regulations, we have no control over the ultimate actions of our independent manufacturers. While our internal and vendor operating guidelines promote ethical business practices and our staff and buying agents periodically visit and monitor the operations of our independent manufacturers, we do not control these manufacturers or their labor practices. The violation of labor or other laws by an independent manufacturer of ours, or by one of our licensing partners, or the divergence of an independent manufacturer's or licensing partner's labor practices from those generally accepted as ethical in the United States, could interrupt, or otherwise disrupt the shipment of finished products to us or damage our reputation. Any of these, in turn, could have a material adverse effect on our financial condition and results of operations, such as the loss of potential revenue and incurring additional expenses.

The Failure To Manage Our Growth In Operations And Acquisitions Of New Product Lines And New Businesses Could Have A Material Adverse Effect On Us.

The expected growth of our operations (as to which no representation can be made) will place a significant strain on our current management resources. To manage this expected growth, we will need to improve our:

- o operations and financial systems;
- o procedures and controls; and
- o training and management of our employees.

Our future growth may be attributable to acquisitions of and new product lines and new businesses. We expect that future acquisitions, if successfully consummated, will create increased working capital requirements, which will likely precede by several months any material contribution of an acquisition to our net income.

Our failure to manage growth or future acquisitions successfully could seriously harm our operating results. Also, acquisition costs could cause our quarterly operating results to vary significantly.

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Furthermore, our stockholders would be diluted if we financed the acquisitions by incurring convertible debt or issuing securities.

Although we currently only have operations within the United States, if we were to acquire an international operation; we will face additional risks, including:

- o difficulties in staffing, managing and integrating international operations due to language, cultural or other differences;
- o different or conflicting regulatory or legal requirements;
- o foreign currency fluctuations; and
- o diversion of significant time and attention of our management.

If We Are Unable to Retain the Services of Messrs. Sheu, Hayward or Liang, or If

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We Are Unable to Successfully Recruit Qualified Managerial and Sales Personnel Having Experience in Business, We May Not Be Able to Continue Our Operations.

Our success depends to a significant extent upon the continued service of Dr. Jun-Jei Sheu, the Chairman of our Board of Directors; Dr. James A. Hayward, our Chief Executive Officer; and Dr. Benjamin Liang, our Secretary and Strategic Technology Development Officer. We do not have employment agreements with Drs. Sheu, Hayward or Liang. Loss of the services of Drs. Sheu, Hayward or Liang could have a material adverse effect on our growth, revenues, and prospective business. We do not maintain key-man insurance on the life of Drs. Sheu, Hayward or Liang. We are not aware of any named executive officer or director who has plans to leave us or retire. In addition, in order to successfully implement and manage our business plan, we will be dependent upon, among other things, successfully recruiting qualified managerial and sales personnel having experience in business. Competition for qualified individuals is intense. There can be no assurance that we will be able to find, attract and retain existing employees or that we will be able to find, attract and retain qualified personnel on acceptable terms.

Failure to Attract and Retain Qualified Scientific or Production Personnel Could Have a Material Adverse Effect On Us.

Recruiting and retaining qualified scientific and production personnel to perform research and development work and product manufacturing is critical to our success. Because the industry in which we compete is very competitive, we face significant challenges attracting and retaining a qualified personnel base. Although we believe we have been and will be able to attract and retain these personnel, there is no assurance that we will be able to continue to successfully attract qualified personnel. In addition, our anticipated growth and expansion into areas and activities requiring additional expertise, such as clinical testing, government approvals, production, and marketing will require the addition of new management personnel and the development of additional expertise by existing management personnel. The failure to attract and retain these personnel or, alternatively, to develop this expertise internally would adversely affect our business as our ability to conduct research and development will be reduced or eliminated, resulting in fewer or no products for sale and lower revenues. We generally do not enter into employment agreements requiring these employees to continue in our employment for any period of time.

We Need to Expand Our Sales and Support Organizations to Increase Market Acceptance of Our Products.

We currently have a small customer service and support organization and will need to increase our staff to support new customers and the expanding needs of existing customers. The employment market for sales personnel, and customer service and support personnel in this industry is very competitive, and we may not be able to hire the kind and number of sales personnel, customer service and support personnel we are targeting. Our inability to hire qualified sales, customer service and support personnel may materially adversely affect our business, operating results and financial condition.

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The DNA Security Technology Industry is Very Competitive, and We May Be Unable to Continue to Compete Effectively in this Industry in the Future.

We are engaged in a segment of the DNA security technology industry that is highly competitive. We compete with many other suppliers and new competitors continue to enter the market. Many of our competitors, both in the United States and elsewhere, also work with major pharmaceutical, chemical and biotechnology companies, and many of them have substantially greater capital resources,



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marketing experience, research and development staff, and facilities than we do. Any of these companies could succeed in developing products that are more effective than the products that we have or may develop and may be more successful than us in producing and marketing their products. It is impossible to quantify the number of competitors since they include both the companies we attempt to sell our products and services to through their use of internal security and various other security product companies. Some of the anti-counterfeiting and fraud protection competitors that we are aware of include: Authentix, InkSure, DNA Technologies, Inc., Art Guard International, Theft Protection Systems, Tracetag and November AG. Although it is impossible to determine the total market size and market data information because companies are secretive about what security methods they utilize and how much they spend on such measures, we have determined that approximate annual sales by some of our competitors have been as follows:

- o InkSure - \$1 million
- o DNA Technologies, Inc. - \$22.6 million
- o November AG - \$5.8 million

We expect this competition to continue and intensify in the future. Competition in our markets is primarily driven by:

- o product performance, features and liability;
- o price;
- o timing of product introductions;
- o ability to develop, maintain and protect proprietary products and technologies;
- o sales and distribution capabilities;
- o technical support and service;
- o brand loyalty;
- o applications support; and
- o breadth of product line.

If a competitor develops superior technology or cost-effective alternatives to our products, our business, financial condition and results of operations could be materially adversely affected.

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Our Trademark and Other Intellectual Property Rights May not be Adequately Protected Outside the United States, Resulting in Loss of Revenue.

We believe that our trademarks, whether licensed or owned by us, and other proprietary rights are important to our success and our competitive position. In the course of our international expansion, we may, however, experience conflict with various third parties who acquire or claim ownership rights in certain trademarks. We cannot assure that the actions we have taken to establish and protect these trademarks and other proprietary rights will be adequate to prevent imitation of our products by others or to prevent others from seeking to block sales of our products as a violation of the trademarks and proprietary rights of others. Also, we cannot assure you that others will not

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assert rights in, or ownership of, trademarks and other proprietary rights of ours or that we will be able to successfully resolve these types of conflicts to our satisfaction. In addition, the laws of certain foreign countries may not protect proprietary rights to the same extent, as do the laws of the United States.

Intellectual Property Litigation Could Harm Our Business.

Litigation regarding patents and other intellectual property rights is extensive in the biotechnology industry. In the event of an intellectual property dispute, we may be forced to litigate. This litigation could involve proceedings instituted by the U.S. Patent and Trademark Office or the International Trade Commission, as well as proceedings brought directly by affected third parties. Intellectual property litigation can be extremely expensive, and these expenses, as well as the consequences should we not prevail, could seriously harm our business.

If a third party claims an intellectual property right to technology we use, we might need to discontinue an important product or product line, alter our products and processes, pay license fees or cease our affected business activities. Although we might under these circumstances attempt to obtain a license to this intellectual property, we may not be able to do so on favorable terms, or at all. We are currently not aware of any intellectual property rights that are being infringed nor have we received notice from a third party that we may be infringing on any of their patents.

Furthermore, a third party may claim that we are using inventions covered by the third party's patent rights and may go to court to stop us from engaging in our normal operations and activities, including making or selling our product candidates. These lawsuits are costly and could affect our results of operations and divert the attention of managerial and technical personnel. There is a risk that a court would decide that we are infringing the third party's patents and would order us to stop the activities covered by the patents. In addition, there is a risk that a court will order us to pay the other party damages for having violated the other party's patents. The biotechnology industry has produced a proliferation of patents, and it is not always clear to industry participants, including us, which patents cover various types of products or methods of use. The coverage of patents is subject to interpretation by the courts, and the interpretation is not always uniform. If we are sued for patent infringement, we would need to demonstrate that our products or methods of use either do not infringe the patent claims of the relevant patent and/or that the patent claims are invalid, and we may not be able to do this. Proving invalidity, in particular, is difficult since it requires a showing of clear and convincing evidence to overcome the presumption of validity enjoyed by issued patents.

Because some patent applications in the United States may be maintained in secrecy until the patents are issued, because patent applications in the United States and many foreign jurisdictions are typically not published until eighteen months after filing, and because publications in the scientific literature often lag behind actual discoveries, we cannot be certain that others have not filed patent applications for technology covered by our licensors' issued patents or our pending applications or our licensors' pending applications or that we or our licensors were the first to invent the technology. Our competitors may have filed, and may in the future file, patent applications covering technology similar to ours. Any such patent application may have priority over our or our licensors' patent applications and could further require us to obtain rights to issued patents covering such technologies. If another party has filed a United States patent application on inventions similar to ours, we may have to participate in an interference proceeding declared by the United States Patent and Trademark Office to determine priority of invention in the United States. The costs of these

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proceedings could be substantial, and it is possible that such efforts would be unsuccessful, resulting in a loss of our United States patent position with respect to such inventions.

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Some of our competitors may be able to sustain the costs of complex patent litigation more effectively than we can because they have substantially greater resources. In addition, any uncertainties resulting from the initiation and continuation of any litigation could have a material adverse effect on our ability to raise the funds necessary to continue our operations.

### Accidents Related to Hazardous Materials Could Adversely Affect Our Business.

Some of our operations require the controlled use of hazardous materials. Although we believe our safety procedures comply with the standards prescribed by federal, state, local and foreign regulations, the risk of accidental contamination of property or injury to individuals from these materials cannot be completely eliminated. In the event of an accident, we could be liable for any damages that result, which could seriously damage our business and results of operations.

### Potential Product Liability Claims Could Affect Our Earnings and Financial Condition.

We face a potential risk of liability claims based on our products and services, and we have faced such claims in the past. We currently do not have any product liability coverage but are attempting to obtain coverage which we will believe to be adequate. We cannot assure, however, that we will be able to obtain or maintain this insurance at reasonable cost and on reasonable terms. We also cannot assure that this insurance, if obtained, will be adequate to protect us against a product liability claim, should one arise. In the event that a product liability claim is successfully brought against us, it could result in a significant decrease in our liquidity or assets, which could result in the reduction or termination of our business.

### Litigation Generally Could Affect Our Financial Condition and Results of Operations.

We generally may be subject to claims made by and required to respond to litigation brought by former employees, former officers and directors, and vendors and service providers. We have faced such claims in the past and we cannot assure that we will not be subject to claims in the future. In the event that a claim is successfully brought against us, considering our lack of revenue and the losses our business has incurred for the period from our inception to March 31, 2006, this could result in a significant decrease in our liquidity or assets, which could result in the reduction or termination of our business.

### Our Failure to File a Registration Statement Could Affect Our Financial Condition and Results of Operations.

In June 2005, we engaged Trilogy Capital Partners, Inc. ("Trilogy") as consultants. In connection with that engagement we issued Trilogy warrants to purchase 7,500,000 shares of our common stock at a price of \$0.55 per share. We also agreed to file a registration statement with the SEC with respect to the shares underlying such warrants no later than the earlier to occur of: (i) 15 days following the effectiveness of the registration statement of which this prospectus forms a part, or (ii) September 15, 2005. As of the date hereof we have not filed a registration statement with respect to the shares of our common stock underlying the warrants we issued to Trilogy. In the event that a claim is

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successfully brought by Trilogy against us with respect to this matter, it could result in a significant decrease in our liquidity or assets, which could result in the reduction or termination of our business.

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We Were Obligated to Pay Liquidated Damages As a Result of Our Failure to Have a Registration Statement Declared Effective Prior to June 15, 2005, and any Payment of Liquidated Damages Will Either Result in Depletion of Our Working Capital or Issuance of Shares of Common Stock Which Would Cause Dilution to Our Existing Shareholders.

Pursuant to the terms of our private placement that closed in January and February 2005, if we did not have a registration statement registering the shares underlying the convertible notes and warrants declared effective on or before June 15, 2005, we are obligated to pay liquidated damages in the amount of 3.5% per month of the face amount of the notes until the registration statement is declared effective. At our option, these liquidated damages can be paid in cash or restricted shares of our common stock. Thus far we have decided to pay the liquidated damages in common stock, although any future payments of liquidated damages may, at our option, be made in cash. If we decide to pay such liquidated damages in cash, we would be required to use our limited working capital and potentially raise additional funds. If we decide to pay the liquidated damages in shares of common stock, the number of shares issued would depend on our stock price at the time that payment is due. Based on the closing market prices of \$0.66, \$0.58, \$0.70, \$0.49, \$0.32 and \$0.20 for our common stock on July 15, 2005, August 15, 2005, September 15, 2005, October 17, 2005, November 15, 2005 and December 15, 2005, respectively, we issued a total of 3,807,375 shares of common stock in liquidated damages from August, 2005 to January, 2006. The issuance of shares upon payment of liquidated damages will have the effect of further diluting the proportionate equity interest and voting power of holders of our common stock, including investors in this offering.

Liquidated damages in the form of common stock were paid for the period from June 15, 2005 to December 15, 2005. We believe that we have no enforceable obligation to pay further liquidated damages since the shares we agreed to register for resale are eligible for resale under Rule 144 of the Securities Act of 1933, as amended, and such continuing liquidated damages are grossly inconsistent with actual damages to the purchasers of the notes and warrants. However, we are seeking to confirm this position by obtaining the waiver and release of the holders of these securities of further liquidated damages. If these persons do not waive and release and successfully bring a claim against us with respect to such liquidated damages, it could result in a significant decrease in our liquidity or assets, which could result in the reduction or termination of our business.

### Matters Voluntarily Reported to the SEC and Securities Act Violations

We previously disclosed that we were investigating the circumstances surrounding certain issuances of shares to employees and consultants in 2005, and have engaged our new outside counsel to conduct this investigation. We have voluntarily reported our current findings from the investigation to the SEC, and we have agreed to provide the SEC with further information arising from the investigation. We believe that the issuance of 8,000,000 shares to employees in July 2005 was effectuated by both our former President and our former Chief Financial Officer/Chief Operating Officer without approval of the board of directors. These former officers received a total of 3,000,000 of these shares. In addition, it appears that the 8,000,000 shares issued in July 2005, as well as an additional 550,000 shares issued to employees and consultants in March, May and August 2005, were improperly issued without a restrictive legend stating that the shares could not be resold legally except in compliance with the

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Securities Act of 1933, as amended. Our investigation is continuing. The members of our management who effectuated the stock issuances that are being examined in the investigation no longer work for us. We believe that we may incur significant costs and expenses in continuing this investigation.

In the event that any of the exemptions from registration with respect to the issuance of our common stock under federal and applicable state securities laws were not available, we may be subject to claims by federal and state regulators for any such violations. In addition, if any purchaser of our common stock were to prevail in a suit resulting from a violation of federal or applicable state securities laws, we could be liable to return the amount paid for such securities with interest thereon, less the amount of any income received thereon, upon tender of such securities, or for damages if the purchaser no longer owns the securities. As of the date of these financial statements, we are not aware of any alleged specific violation or the likelihood of any claim. There can be no assurance that litigation asserting such claims will not be initiated, or that we would prevail in any such litigation.

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### RISKS RELATING TO OUR COMMON STOCK

There Are a Large Number of Shares Underlying Our Options and Warrants That May be Available for Future Sale and the Sale of These Shares May Depress the Market Price of Our Common Stock and Will Cause Immediate and Substantial Dilution to Our Existing Stockholders.

As of March 31, 2006, we had 118,582,385 shares of common stock issued and outstanding and outstanding options and warrants to purchase in the aggregate approximately 49,229,464 shares of common stock. All of the shares issuable upon exercise of our options and warrants may be sold without restriction. The sale of these shares may adversely affect the market price of our common stock. The issuance of shares upon exercise of options and warrants will cause immediate and substantial dilution to the interests of other stockholders since the selling stockholders may convert and sell the full amount issuable on exercise.

If We Fail to Remain Current on Our Reporting Requirements, We Could be Removed From the OTC Bulletin Board Which Would Limit the Ability of Broker-Dealers to Sell Our Securities and the Ability of Stockholders to Sell Their Securities in the Secondary Market.

Companies trading on The Over The Counter Bulletin Board ("OTC Bulletin Board"), such as us, must be reporting issuers under Section 12 of the Securities Exchange Act of 1934, as amended, and must be current in their reports under Section 13, in order to maintain price quotation privileges on the OTC Bulletin Board. If we fail to remain current on our reporting requirements, we could be removed from the OTC Bulletin Board. As a result, the market liquidity for our securities could be severely adversely affected by limiting the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market. Prior to May 2001 and new management, we were delinquent in our reporting requirements, having failed to file our quarterly and annual reports for the years ended 1998 - 2000 (except the quarterly reports for the first two quarters of 1999). We have been current in our reporting requirements for the last three years, however, there can be no assurance that in the future we will always be current in our reporting requirements.

Our Common Stock is Subject to the "Penny Stock" Rules of the SEC and the Trading Market in Our Securities is Limited, Which Makes Transactions in Our Stock Cumbersome and May Reduce the Value of an Investment in Our Stock.

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The SEC has adopted Rule 15g-9 which establishes the definition of a "penny stock," for the purposes relevant to us, as any equity security that has a market price of less than \$5.00 per share or with an exercise price of less than \$5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require:

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- o that a broker or dealer approve a person's account for transactions in penny stocks; and
- o the broker or dealer receive from the investor a written agreement to the transaction, setting forth the identity and quantity of the penny stock to be purchased.
- o In order to approve a person's account for transactions in penny stocks, the broker or dealer must:
- o obtain financial information and investment experience objectives of the person; and
- o make a reasonable determination that the transactions in penny stocks are suitable for that person and the person has sufficient knowledge and experience in financial matters to be capable of evaluating the risks of transactions in penny stocks.

The broker or dealer must also deliver, prior to any transaction in a penny stock, a disclosure schedule prescribed by the Commission relating to the penny stock market, which, in highlight form:

- o sets forth the basis on which the broker or dealer made the suitability determination; and
- o that the broker or dealer received a signed, written agreement from the investor prior to the transaction.

Generally, brokers may be less willing to execute transactions in securities subject to the "penny stock" rules. This may make it more difficult for investors to dispose of our common stock and cause a decline in the market value of our stock.

Disclosure also has to be made about the risks of investing in penny stocks in both public offerings and in secondary trading and about the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and the rights and remedies available to an investor in cases of fraud in penny stock transactions. Finally, monthly statements have to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

### ITEM 3. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

As of March 31, 2006, our management carried out an evaluation, under the supervision of our Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of our system of disclosure controls and procedures pursuant to the Securities and Exchange Act, Rule 13a-15(e) and 15d-15(e) under the Exchange Act). Based on that evaluation, our chief executive officer and chief financial officer concluded that our

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disclosure controls and procedures are not effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is not accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. Please see the subsection "Significant Deficiencies In Disclosure Controls And Procedures Or Internal Controls" below.

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### Changes in internal controls

Except as described below, there were no changes in internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially effect, our internal control over financial reporting. As described below, as a result of our evaluation of our disclosure controls and procedures as of March 31, 2006, we determined that our controls and procedures are not effective and subsequent to the period of this report, began to implement changes to our internal controls.

### Significant Deficiencies In Disclosure Controls And Procedures Or Internal Controls

As previously reported, on July 11, 2005, we determined there were errors in accounting for the valuation of equity consulting service transactions during the January through March 2005 time period. The valuation resulted in the overstatement of approximately \$2.9 million in services provided. The errors were discovered in connection with a comment raised by the SEC in their review and comment on our registration statement on Form SB-2. The SEC requested that we provided additional disclosure regarding issuances of common stock to non-employees in exchange for services. Upon reviewing and updating our disclosure, we discovered our errors. During the quarter ended March 31, 2006, we implemented the following changes in our internal controls to resolve these weaknesses and deficiencies:

Establish and maintain a separate binder of all board authorized activities and a binder with forward looking "budget" of anticipated or contemplated activity for each of the following:

- o shares issued for services;
- o shares issued for employees;
- o warrant exercises;
- o option exercises;
- o authorized shares and warrant re-pricing;
- o shares issued in exchange for debt; and
- o upcoming ESOP grants and exercises;
- o require the signature of the principal executive and accounting officers for all issuances of securities;
- o require monthly review of share issuances compared to binders; and

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- o authorize our transfer agent to handle and track all warrants and ESOP grants.

We believe that these actions will correct the material deficiencies and significant weaknesses in our controls and procedures.

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### PART II--OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. Except as described below, we are currently not aware of any such legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

Crystal Research Associates, LLC v. Applied DNA Sciences, Inc., Docket No.: L-7947-04

On April 29, 2005, Crystal Research Associates, LLC obtained a default judgment against us for \$13,000 in the Superior Court of New Jersey, Middlesex County. We intend to move to vacate the default judgment on various grounds. The plaintiff has agreed in principle to settle this matter with us in exchange for a cash payment, but, as of the date hereof, we have not executed a settlement agreement.

Paul Reep v. Applied DNA Sciences, Inc., Case No.: BC345702

Plaintiff Paul Reep, a former employee, commenced this action against us in the Superior Court for the Sate of California for the County of Los Angeles on January 10, 2006. Paul Reep asserts eight causes of action for breach of contract, breach of an oral agreement, negligent misrepresentation, interference with prospective business advantages, defamation, fraud, accounting and constructive trust, unjust enrichment. The relief sought includes damages and attorneys' fees. We dispute all of the allegations of this complaint and intend to vigorously defend this mater. In this matter we have asked the court to make a judicial determination that an agreement, which we did not authorize and which is the basis of previously disclosed litigation against us by Paul Reep, our former employee, and a new action filed by our former employees as set forth in the subsequent paragraphs is invalid and unenforceable. This matter is in its early stages.

Applied DNA Sciences, Inc. v. Paul Reep, Adrian Butash, John Barnett, Chanty Cheang, Jaime Cardona, and Angela Wiggins, Case No. CV06-2027 RGK

We filed this action against the defendants, Paul Reep, Adrian Butash, John Barnett, Chanty Cheang, Jaime Cardona, and Angela Wiggins on April 4, 2006, in the United States District Court for the Central District of California. In this matter we have asked the court to make a judicial determination that an agreement, which we did not authorize and which is the basis of previously disclosed litigation against us by Paul Reep, our former employee, is invalid and unenforceable. This matter is in its early stages.

Barnett, et al. v. Applied DNA Sciences, et al., Case No.: BC 350904



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Plaintiffs John D. Barnett, Jr., Adrian Butash, Jaime A. Cardona, and Chanty Cheang, our former employees, filed suit against us, Applied DNA Operations Management, Inc., APDN (B.V.I.), Inc., Peter Brocklesby, James A. Hayward, and Jun-Jei Sheu in Los Angeles County Superior Court on April 17, 2006. The complaint alleges causes of action for breach of written contract, breach of oral contract, fraud, violations of the California Labor Code, and wrongful termination. We dispute all of the allegations and intend to vigorously defend this action. This matter is in its early stages.

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### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On March 8, 2006, we completed a private placement offering in which 30 units (the "Units") of our securities were sold, each Unit consisting of (i) a \$50,000 Principal Amount 10% Secured Convertible Promissory Note (the "Notes") and (ii) a warrant (the "Warrants") to purchase 100,000 shares of our common stock, or an aggregate of \$1,500,000 in principal amount of Notes and Warrants to purchase 3,000,000 shares of common stock, for aggregate gross proceeds of \$1,500,000. The Units were sold pursuant to Subscription Agreements, by and between each of the purchasers and Applied DNA Operations Management, Inc., our wholly owned subsidiary. This issuance is considered exempt under Regulation S of the Securities Act of 1933.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

### ITEM 5. OTHER INFORMATION

#### Litigation

We previously disclosed that plaintiff James Paul Brown, filed an action against us in the Superior Court for the State of California for the County of Los Angeles on January 12, 2006 (James Paul Brown v. Applied DNA Sciences, Inc., Case No. BC 3457814). The complaint asserted a single cause of action for breach of an alleged oral consulting agreement. The relief sought included money damages and attorneys' fees. The parties have executed a settlement agreement, we have performed our obligations under such agreement, and this matter has been dismissed with prejudice.

We previously disclosed that plaintiff Rubenstein Public Relations, Inc. commenced an action against us in the Civil Court of the City of New York, County of New York, in New York State Rubenstein Public Relations, Inc. v. Applied DNA Sciences, Inc.). Plaintiff Rubenstein Public Relations, Inc. asserted a cause of action for breach of contract based upon the allegations that we failed to make payments pursuant to a March 2005 investor relations consulting agreement governed by New York law. Rubenstein Public Relations, Inc. sought damages in the amount \$43,000. The parties have executed a settlement agreement, we have performed our obligations under such agreement, and this matter has been dismissed with prejudice.

#### Related Party Transactions

On May 9, 2006, we issued a press release to announce that we had entered into a Business Development and Trademark License Agreement with Dr. Suwelack Skin & Health Care AG ("Dr. Suwelack") providing Dr. Suwelack rights to

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use our SigNature(TM) logo, which is printed with ink containing our proprietary encrypted botanical DNA technology, and to participate in our SigNature(TM) Program. The terms of this one year license agreement provide Suwelack with a limited, non-exclusive, non-transferable right to use the SigNature(TM) logo on its packaging and labels. Dr. Suwelack will pay us a one time license fee in the amount of EUR15,000 in consideration for the use of our SigNature(TM) logo. EUR7,500 of the license fee was due upon signing of the agreement and the remaining 50% is due upon receipt of the shipped labels. James A. Hayward, one of our directors and our Chief Executive Officer ("Dr. Hayward"), serves on Dr. Suwelack's board of directors. BioCogent, whose President and Chief Executive Officer and sole stockholder is Dr. Hayward, provides consulting services to Dr. Suwelack. Dr. Suwelack and BioCogent recently reached an agreement in principle, with respect to which no written agreement has been executed, by which BioCogent will continue to provide consulting services to Dr. Suwelack and Dr. Hayward will serve as Dr. Suwelack's president on a part-time basis reporting to Dr. Suwelack's Chief Executive Officer.

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### ITEM 6. EXHIBITS

- 4.1 Form of Subscription Agreement, filed as an exhibit to the current report on Form 8-K filed with the Commission on March 14, 2006 and incorporated herein by reference.
- 4.9 Form of 10% Secured Convertible Promissory Note of Applied DNA Sciences, Inc., filed as an exhibit to the current report on Form 8-K filed with the Commission on March 14, 2006 and incorporated herein by reference.
- 4.10 Form of Warrant Agreement of Applied DNA Sciences, Inc., filed as an exhibit to the current report on Form 8-K filed with the Commission on March 14, 2006 and incorporated herein by reference.
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)

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### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APPLIED DNA SCIENCES, INC.

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Date: May 23, 2006

By: /s/ JAMES A. HAYWARD  
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James A. Hayward  
Chief Executive Officer (Principal  
Executive Officer, Principal Financial  
Officer and Principal Accounting Officer)

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